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IN THE

Supreme Court of the United States

October Term, 1974.

No. 74-965

WARNER COMPANY,

Petitioner,

v.

UNITED STATES OF AMERICA,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT.

WILLIAM T. COLEMAN, JR.,
JULES I. WHITMAN,
ROBERT W. MARIS,
PETER J. PICOTTE, II,
2600 The Fidelity Building,
Philadelphia, Pennsylvania. 19109
Attorneys for Petitioner, Warner Company.

Of Counsel:
DILWORTH, PAXSON, KALISH,
LEVY & COLEMAN,
2600 The Fidelity Building,
Philadelphia, Pennsylvania. 19109

International Printing Co., 711 So. 50th St., Phila., Pa. 19143 — Tel. (215) 727-8711

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v.

UNITED STATES OF AMERICA,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT.

Petitioner Warner Company prays that a Writ of Certiorari issue to review the judgment of the United States Court of Appeals for the Third Circuit entered on September 27, 1974, which reversed a judgment of the United States District Court for the Eastern District of Pennsylvania.

OPINIONS BELOW.

The Opinion of the Court of Appeals for the Third Circuit is not yet reported. It is reprinted in Appendix B hereto, *infra* pages A6-A31. The Opinion and Order of the United States District Court for the Eastern District of Pennsylvania which were reviewed by the Court of Appeals have not yet been reported. They are reprinted in Appendix C hereto, *infra* pages A32-A74.

JURISDICTION.

The judgment of the Court of Appeals was entered on September 27, 1974. A Petition for Rehearing *en banc* was filed on October 10, 1974, and was denied on November 7, 1974. Jurisdiction of this Court is invoked under 28 U. S. C. § 1254(1).

QUESTIONS PRESENTED.

The Commissioner of Internal Revenue, in direct conflict with statute and with *United States v. Cannelton Sewer Pipe Co.*, 364 U. S. 76, failed to allow Petitioner (an integrated miner-manufacturer of limestone into lime) any percentage depletion allowance whatsoever on its limestone mining operation—when a non-integrated limestone miner similarly situated would have received such allowance—*solely* as the result of Petitioner's integrated status, and the court of appeals, reversing the findings and holding of the district court, approved this result. Therefore the questions presented are:

(1) When Congress has granted a statutory percentage depletion allowance for the mining of a mineral, can a court, by interpreting regulations designed to effectuate the proper grant of that allowance, deprive a mining company of the allowance altogether where the allowance would be available to a non-integrated mining company which was identically situated?

(2) Was it permissible for the court of appeals, in order to apply a treasury regulation in such a way as to deprive petitioner of the statutory depletion allowance given it by Congress, to select arbitrarily and without regard to economic reality a price to be the "representative market or field price" referred to in that regulation when (a) no representative price

for sales of limestone existed in the area in which taxpayer mined and consumed its limestone and (b) the price thus arbitrarily selected was clearly not representative?

STATUTES AND REGULATIONS INVOLVED.

The statutory provisions involved are Sections 611(a), 613(a) and 613(c)(1),(2) of the Internal Revenue Code of 1954 (26 U. S. C.). These are reproduced below. The regulations involved are the following Treasury Regulations under the 1954 Code (26 C. F. R.):

Section 1.613-4(c),(2),(3)
Section 1.613-4(d)(1)(i)
Section 1.613-4(d)(4)(i)
Section 1.613-4(d)(6)
Section 1.613-4(e)(2)(i),(iv) example (2)

Because of their length these Regulations are set forth in Appendix A hereto, *infra* pages A1-A5.

Statutes.

Sec. 611. *Allowance of Deduction for Depletion.*

(a) General Rule.—In the case of mines, oil and gas wells, other natural deposits, and timber, there shall be allowed as a deduction in computing taxable income a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case; such reasonable allowance in all cases to be made under regulations prescribed by the Secretary or his delegate.

• • •

Sec. 613. *Percentage Depletion.*

(a) GENERAL RULE.—In the case of the mines, wells, and other natural deposits listed in subsection (b), the allowance for depletion under section 611 shall be the percentage, specified in subsection (b), of the gross income from the property excluding from such gross income an amount equal to any rents or royalties paid or incurred by the taxpayer in respect of the property. Such allowance shall not exceed 50 percent of the taxpayer's taxable income from the property (computed without allowance for depletion).

* * *

(c) DEFINITION OF GROSS INCOME FROM PROPERTY.—For purposes of this section—

(1) GROSS INCOME FROM THE PROPERTY.—The term "gross income from the property" means, in the case of a property other than an oil or gas well, the gross income from mining.

(2) MINING.—The term "mining" includes not merely the extraction of the ores or minerals from the ground but also the treatment processes considered as mining described in paragraph (4) (and the treatment processes necessary or incidental thereto), and so much of the transportation of ores or minerals (whether or not by common carrier) from the point of extraction from the ground to the plants or mills in which such treatment processes are applied thereto as is not in excess of 50 miles unless the Secretary or his delegate finds that the physical and other requirements are such that the ore or mineral must be transported a greater distance to such plants or mills.

STATEMENT OF THE CASE.

Petitioner Warner Company ("Warner") is an integrated miner-manufacturer engaged in mining high calcium limestone at Bellefonte, Pennsylvania, and manufacturing it into lime and lime products, also at Bellefonte (A36).* Warner's integrated Bellefonte lime operation enjoyed a net profit for each of the years (1956-1961) which are the subject matter of this tax refund case (A40).

In order to understand the mistake of the court below it is not necessary to consider in detail the technical properties of limestone mining and processing. It need only be pointed out that the Bellefonte field is a large and important one—the largest high calcium limestone production field in Pennsylvania and the Eastern United States and the second largest high calcium lime producing area in the United States (A57). The high calcium deposits there are necessarily mined by a relatively expensive underground method, rather than by quarrying (A36-37, 39). Three major integrated companies, Warner, National Gypsum and Standard Lime and Cement Company, mine the field and compete in the manufacture and sale of lime (A40).

For present purposes, limestone has two distinct major uses. One is for the manufacture of lime (as at Bellefonte) and the other is as part of the process of making steel (A35). The existence of a separate *consuming market* at Pittsburgh, Pennsylvania, for this latter use led the court of appeals into the basic error in its decision, as discussed below. However, no significant amount of limestone is sold from the Bellefonte area to Pittsburgh or elsewhere, and none is sold from anywhere

* References are either to the Appendix hereto (*e.g.*, A24) or to the Appendix before the court below (*e.g.*, R24).

else to Bellefonte (*e.g.*, A48, 68; R 108-09, 113-15). Bellefonte is a self-contained mining and manufacturing (consumption market) area (A55, 57). The district court found that Bellefonte was one of the three separate, major high calcium limestone consumption areas in Pennsylvania (A48).

The present case involves a percentage depletion allowance sought by Warner on its limestone mining operations for the years 1956 through 1961 under 26 U. S. C. §§ 611 and 613 (A60). Under these provisions of the Internal Revenue Code a mining company is entitled to percentage depletion on the mined material based on its "gross income" from the mining operation (with a potential limitation based on its "net income" from mining). However, when the mining "company" is only an integrated arm of a combined mining and manufacturing company, the issue inevitably arises as to what constitutes the "gross income" of the mining component of the operation.

This Court's landmark decision in *United States v. Cannelton Sewer Pipe Co.*, 364 U. S. 76, rejected the then-existing practice that "gross income" be determined on the first actually marketed product of the integrated company. The proper comparison, this Court said, was with the marketable product of non-integrated mining companies which mine the same mineral. If a market for such a product exists, then the integrated company is to be viewed as two separate "disintegrated" companies, with the mining "half" "selling" to the manufacturing "half."[1] The value of this "sale" determines the "gross income" from mining for depletion allowance purposes. However, the specific issue presented and decided in *Cannelton* does not exist here, because the parties stipulated that the crushed limestone consumed by Warner in the manufacturing of lime was the relevant product to be depleted.

1. See the *Cannelton* case, *supra*, at 87 and 89; *infra* p. 11.

The crucial issue here, therefore, was the constructive "sales price" for the intra-company transfer at Bellefonte of crushed limestone so that gross income could be calculated. Determination of this hypothetical "price" is made under Treasury Regulations § 1.613-4. The methods there provided, which take preferential precedence, are, in order:

(1) Use of a "representative market or field price";

(2) Use of a "proportionate profits" method, working back from the profitable actual sale of the manufactured product; and

(3) Use of a tertiary method such as the "other market" method using "representative market or field prices established outside [taxpayer's] market." (See Treas. Regs. 1.613-4(d)(6)).

A significant difference between the "representative market or field price" method and the "proportionate profits" method is that under the proportionate profits method an integrated taxpayer who shows some profit on its ultimate sales will receive a percentage depletion allowance, whereas under the representative market or field price method the taxpayer might be denied all depletion allowance whatsoever.[2] Therefore, since the use of the "representative market or field price" method contains the potential of the denial of depletion allowance, a proper application of the term "representative" to the economic facts on the record becomes crucial.

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2. This is because 26 U. S. C. § 613 provides that the percentage depletion allowance may not exceed fifty percent of the net income from mining. If the Commissioner is free to search far and wide for a constructive field price lower than a taxpayer's actual mining costs he could almost always deprive the taxpayer of the depletion allowance regardless of the fact that the taxpayer is actually depleting his valuable mineral resources.

Warner urged and the district court agreed that since there were admittedly neither significant sales of limestone nor purchases of limestone on the competitive market in the Bellefonte area (A68-69), and since that area was sufficiently separated from other limestone fields by a "prohibitive gulf of freight rates,"[3] *Kaiser Steel Corp. v. United States*, 411 F. 2d 335, 352 (9th Cir., 1969), no "representative" market or field price existed for Bellefonte; the price urged by the United States was not representative; and the "proportionate profits" method should be used (A72-74). In so deciding the district court properly recognized the fact that the existence of Warner's manufacturing "half" in Bellefonte as well as the manufacturing "halves" of the other Bellefonte integrated lime producers created a large and profitable Bellefonte market which meant that the mining "halves" of these companies would never need to sell elsewhere and certainly not at a loss (A62-64).

The district court thus conformed to this Court's requirement in depletion allowance cases that integrated operators be treated as selling to themselves.[4]

The court of appeals, in reversing, cut loose from one of the anchors in reality of the *Cannelton* test—the point of consumption by the manufacturing "half." It held that in looking for a "representative" market or field price the Commissioner was not constrained by the reality of the actual transaction he was dealing with, but might range

3. All three Bellefonte lime producers unequivocally testified that if they had to purchase their limestone outside of the Bellefonte field, the high freight cost would make the delivered price of limestone so high that they would be obliged to discontinue the manufacture of lime (R 48, 49, 54, Tr. 353-54; A41, R 96; Exh. J-1T, P. 5; Exh. J-1U, P. 1).

4. The district court found that a disintegrated Warner mining company could and would have sold its limestone in Bellefonte at a price in excess of $2.00 per ton (A58). It thus rejected the constructive sales price of $1.76 or less per ton urged by the Commissioner on the grounds that it was not "representative" of Warner's market or field price (A58-59).

freely over the landscape looking for any sales of the same mineral anywhere by a non-integrated miner at any price that might serve to defeat the taxpayer's entitlement to a depletion allowance for the mineral he was in fact depleting.

This decision, apart from being unjust to the present taxpayer,[5] conflicts with decisions of other courts of appeals and confers on the Commissioner such free-floating discretion to defeat Congressional intent, that it prompted the present petition for certiorari.

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5. All three Bellefonte lime producers had mining costs of the same approximate magnitude, well in excess of the representative price determined by the court of appeals (based on f.o.b. prices paid by Pittsburgh consumers to Virginia Valley sellers) (A39, 40, 42). Accordingly, the necessary prospective consequence of the Court's decision is to disallow all percentage depletion to these producers who extracted approximately 93% of the limestone from the vast Bellefonte field. To disallow virtually all depletion to the Bellefonte field where the limestone mined has substantial value to the manufacturers of lime, merely because lower cost producers in the Virginia Valley field sell limestone for a comparatively lower f.o.b. (but higher delivered) price to Pittsburgh steel companies for use in the manufacture of steel is wholly illogical and does not comport with reality.

REASONS FOR GRANTING THE WRIT.

I. The Decision Below Conflicts With This Court's Decision in *United States v. Cannelton Sewer Pipe Co.*

Sections 611 and 613 of the Internal Revenue Code of 1959 grant a depletion allowance to a taxpayer on a percentage of its "gross income from mining." 26 U. S. C. §§ 611, 613. If the taxpayer is engaged only in the business of mining, little problem in ascertaining that "gross income" arises and if it shows a net profit for a given year it is entitled to some allowance, regardless of its costs. However, when the taxpayer is an integrated miner-manufacturer, using the raw product of its mining operation to manufacture finished products which it then sells, two special issues arise: (1) the point at which the mining operation stops and (2) the proper method of computing the hypothetical "gross income" to be attributed to the transfer of raw materials at that point.

In *United States v. Cannelton Sewer Pipe Co.*, 364 U. S. 76, this Court, in holding that mining operations stop at the conclusion of the mining process, construed the Congressional intent with regard to depletion allowance for integrated companies to be:

> "As we see it, the miner-manufacturer is but selling to himself the crude mineral that he mines, insofar as the depletion allowance is concerned." 364 U. S. at 87.
>
> • • •
>
> "We believe that the Congress intended integrated mining-manufacturing operations to be treated as if the operator was selling the mineral mined to himself for fabrication." *Id.* at 89.

In the present case the parties stipulated the point at which limestone mining stopped in the integrated lime producing operation. Therefore the court below faced only the second of the two questions posed by integration—the proper method of computing a hypothetical "gross income" for the actual transfer of the crushed limestone tonnage during the years in question.

In direct conflict with the intent of Congress declared in *Cannelton* the court below disregarded the status of an integrated operator as one "selling . . . to *himself* for fabrication" and held:

> "[T]he inquiry is the price a *consumer* would pay for the raw mineral mined by the mining 'half.' It is *not* what the manufacturing 'half' would pay. . . ." (A18) (emphasis added) [6]
>
> • • •
>
> "We are not concerned with the price that Warner's manufacturing half would pay for limestone whether . . . purchased at Bellefonte or purchased from other producing areas and shipped to Bellefonte." (A23-24)

This elimination from consideration of the purchasing "half" of an integrated operation led the court below to create, in reverse, the very discrimination between integrated and non-integrated operators which this Court sought in *Cannelton* to eliminate. The "buyer" cannot be disregarded because it provides the essential link to reality necessary to effectuate the Congressional purpose. Indeed the court below spoke as if the enormous Bellefonte consumption market did not exist at all.

The decision of the court below was unfortunately dictated by its misconception of the question of Warner's cost

6. The manufacturing "half" was of course a consumer too, a crucial fact the court of appeals failed to recognize.

of mining (discussed in the section of its opinion entitled "Profitability"), a question only tangentially relevant to the issue before it. Analysis of the court's reasoning reveals it to be circular and destructive of the Congressional purpose. To speak, as the court below did, of the "high cost," "lack of profitability," or "loss operation" of the mining "half" of an integrated operation which is profitable overall, is to beg the real question: high cost in relation to what?

To understand the statutory significance of this pivotal question one must start from two undisputed facts:

> (1) A *non-integrated* mining company is statutorily entitled to percentage depletion regardless of its "high" (or "low") costs if it in fact sells at a net profit to an unrelated buyer who is willing to pay the "high" price which generates the profit (perhaps because of geographical location and freight factors);
>
> (2) A *non-integrated* operator is *not* entitled to a depletion allowance on its mining operation, whether its costs are "high" (or "low"), if that operation is in fact operated at a loss in a given year.

Thus for non-integrated mining companies the characterization of costs as "high" or "low" is irrelevant to the statutory purpose. This Court has said the same must be true for integrated operators.

Therefore, under *Cannelton's* principle of *equality* of treatment for integrated and non-integrated, the real question a court must resolve if it is to implement the Congressional intent properly, is which category a given *integrated* operator properly falls into. Characterization of Warner's costs as "high" or "low," as the court below did, is irrelevant to this determination and misleading. The issue can only be correctly and fairly decided by looking at *economic*

reality rather than at an unrealistic hypothetical presumption.

It is in properly resolving this issue that the factor of the *consuming* "half" of the integrated operator—recognized in *Cannelton* but wrongly excluded by the court below—comes into play. If a market *in fact* exists for the products of the "high" cost mining "half"—whether because of *bona fide* geographic factors or other reasons—and the entire operation is profitable, it can only be assumed that the mining "half" falls in category (1) above, a category of mining companies which Congress intended to enjoy a depletion allowance, regardless of the level of their costs. This enjoyment of the allowance stems *not* from the integrated status of the taxpayer, but from its fortuitous advantage in having a geographically close consumption market, an advantage factor which the statute in no way seeks to eliminate—or every non-integrated miner throughout the country (however profitable) should be denied depletion allowance if its costs exceed the f.o.b. sales price in some other production field or consumption market somewhere else in the country.

It is for this reason that the geographical location of the consuming "half" must be taken into account if discrimination is to be avoided. Compare *Kaiser Steel Corp. v. United States,* 411 F. 2d 335 (9th Cir. 1969), and the Regulations there applied. If there are in fact sales *or* purchases of the commodity in question in substantial amounts in the geographical vicinity of the integrated operator—that is, the area within which freight costs do not become an altering factor—then there exists an objective comparative standard for determining whether the mining costs of a given integrated operator are in fact "high" by comparison at the point where they are incurred. This point is crucial because the only situation in which integrated mining costs can relevantly be said to be "high"

is one in which the manufacturing "half" is indulging or "carrying" the mining "half," because it could have *bought* elsewhere more economically.

If substantial sales or purchases exist (and they did in *Cannelton,* just four miles away—in fact the Cannelton Company itself bought there), then they serve two purposes —they demonstrate that the integrated operator's costs are in fact "high" at the point they are incurred, by realistic comparison, and they provide the "representative market or field price" prescribed by the regulation to effectuate the Congressional intent.

When, however, as in the present case, there are *no* substantial sales *or* purchases of the commodity within the immediate geological or geographical (freight) area, the special issue is presented which the court below resolved incorrectly, unfairly and contrary to *Cannelton.* Indeed, what the court below did in making use of *Virginia Valley* f.o.b. prices for sales to *Pittsburgh* was to improperly apply the teritiary "other market method," confusing it with the *representative* market or field price method.

In the first place, there was no basis to make the first crucial comparison—that the taxpayer's mining costs were "too high" at the point they were incurred. Therefore the court below only begged the question it purported to decide of whether the mine was "operating at a loss" vis-a-vis the manufacturing "half." Indeed, the presumption must be that it was operating at a profit—since Warner Company was operating overall at a profit in each year. If Warner's mining "half" is operating at a profit it is as entitled to depletion allowance as any Jones Limestone Mining Co. selling to Smith Lime Co., regardless of the hypothetical question of whether or not its costs are "high" compared with limestone miners in other parts of the country. There is no warrant in the statute or the regulations for looking to such other parts of the country, picking and choosing

discriminatorily, to see if somewhere an f.o.b. price "lower" than Warner's cost can be found (which if the stone were shipped to Bellefonte would be increased by freight costs that would make the delivered price prohibitive).[7] The mistake of the court of appeals was that, instead of turning to the "proportionate profits" method, it presumed out of th' air, with no support in the record, that Warner's costs were "high" in some absolute sense. To this incorrect presumption the court added the presumption that Warner therefore had to be operating "at a loss" at Bellefonte, and that it therefore must be in category (2)—equivalent to a non-integrated miner operating at a loss. The rest of its opinion is built on this erroneous "factual" presumption of absolute "high cost," a presumption which has support neither in the record nor in reality.

To reach this wrong result the court below abandoned the principle—the mining "half" selling to the manufacturing "half"—and the policy—equality of treatment for integrated and non-integrated—of *Cannelton.* Only this Court can correct the error and injustice flowing from the decision—a decision which, as shown in the following section, creates a conflict in the administration of the tax laws.

II. The Decision Below Conflicts With the Decision in *United States v. Henderson Clay Products.*

The court of appeals in *United States v. Henderson Clay Products,* 324 F. 2d 7 (5th Cir. 1963), was faced with

7. The record establishes that the Steel companies in the Pittsburgh and Bethlehem consumption areas (to the East and West of the Bellefonte area) paid a delivered price in excess of $4.00 per ton for limestone (R 110-121), substantially more than the constructive sales price Warner contends it would charge for its intra-company transfer. Every steel company executive who testified agreed that the price which concerned them as a consumer was the delivered price to their consumption point. The court below passed in silence the dispositive issue of how limestone consumed at Bellefonte could be deemed to have a value in this major consumption area of only $1.76 or less per ton.

an integrated miner-manufacturer of clay which was made into bricks. The taxpayer showed that other non-integrated miners of similar clay received $10.50 per ton, while taxpayer's bricks sold for only $8.75 per ton. Taxpayer claimed that its hypothetical "gross income from mining" should be calculated from the higher price.

In rejecting this claim, the court analysed the basic purpose of the statute and the regulations interpreting it, quoting the case of *Hugoton Production Co. v. United States*, 315 F. 2d 868 (Ct. Cl. 1963):

> " 'Representative market or field price' is not a boiler plate [8] and Hugoton gives us the basic approach with which to attack the question: 'In any event, the prime question in defining representative market or field price must be the purpose for which such a price must be calculated.' 315 F. 2d 868 at 875. 'While the act of Congress and regulations adopted in pursuance thereof must be construed according to their plain import, it should be borne in mind in determining the amount of the depletion allowance that such allowance is intended to represent the amount of capital recovered in the product produced by the well, that is the value of the raw product.' " 324 F. 2d at 15.

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8. Similarly, in *Ames v. United States*, 330 F. 2d 770, 773 (9th Cir., 1964) the Court said:

> "Representative market price is a question of fact. . . . The trial court's finding thereon is not to be set aside unless clearly erroneous and this rule applies not only to the determination of basic facts, but also to factual inferences from undisputed facts. Com'r. v. Duberstein, 363 U. S. 278, 291."

The present case represents the first time a court of appeals has usurped the fact finding perogative of the trial court and reversed its determination as to the appropriate field or market area to be taken into account in determining the existence *vel non* of a representative market or field price.

The Court then applied this principle to the facts before it:

> "Clearly the Kentucky-Tennessee ball clay price of $10.50 per ton is not representative insofar as its use does not fulfill the statutory objective outlined above. This price in no way represents the depletion of the taxpayer's clay resources and *in no way represents the price which a non-integrated brick manufacturer would pay for clay with which to make brick.*" *Ibid.* (Emphasis added.)

The Court held that this Court's discussion of "profitability" in *Cannelton* related only to the issue of where mining stopped and had no relation to the commercial reality of determining a "representative" price under the regulations. It said:

> "Turning again to Cannelton, we observe that in Cannelton the question was one of identifying the first commercially marketable product so as to mark the end of the mining process for the purposes of Section 114(b)(4). The Court held that commercial profitability was not relevant in defining the product which had passed sufficiently from its natural state so as to become marketable. The case was remanded to be treated according to Regulation 39.23(m)—1(e)(3); there is no indication that the proceedings in the Supreme Court have any bearing on this determination over and above the establishment of the 'product' on which the depletion allowance is to be granted. Our conclusion, therefore that the commercial realities demonstrate that the price of $10.50 a ton is not 'representative' is consistent with Cannelton." *Ibid.*[9]

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9. To the same effect is the subsequent case of *Henderson Clay Products v. U. S.*, 377 F. 2d 349 (5th Cir. 1967), where the selling price of the manufactured product exceeded the asserted representative field or market price. See also Treas. Regs. 1.613-3(c)(6)

The court of appeals in the present case held the exact opposite. It said:

> "In *Cannelton* the Supreme Court specifically disapproved of the use of the profitability test in determining depletion allowances . . ." (A14).

It then proceeded, as discussed in the preceding section, to presume without support in the record that Warner Mining was a "loss operation," ignoring the reality of what a Bellefonte purchaser would pay. This presents a serious and continuing conflict in standards for the Internal Revenue Service, which must administer a nationwide tax system, and of course for the taxpayer.

The Supreme Court correctly rejected the criterion of commercial profitability in the context of determining the identity of the "product" entitled to depletion allowance. It thereby eliminated a discriminatory advantage in favor of the integrated operator. However, by carrying this treatment of profitability over into the determination of the existence of a "representative" market or field price, where it has no relevance, the court below created a reverse discrimination.

Nothing in the statute forbids a "high cost" nonintegrated mining company from enjoying a depletion allowance, if it has a "consumer" who would pay it a profit for its mined product. The ruling of the court below, by denying the continued existence of the disintegrated manufacturer as the potential consumer,[10] permits a depletion

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9. (Cont'd.)

which creates the presumption that a price is not representative if it would cause the taxpayer to sell its manufactured product at a loss. This regulation refutes the court of appeals conclusions below that profitability and the price the disintegrated manufacturer would pay are irrelevant.

10. A crucial factor in this case, which was ignored by the Court below, is that Bellefonte is economically separated from other limestone production fields by the high cost of transporting limestone

allowance to such non-integrated miners, while denying it entirely to identically situated miners like Warner, simply because of their integrated status.[11] In reversing the district court, the court of appeals acted in direct conflict with this Court in *Cannelton* and the court of appeals in *Henderson* as well as every other court which has considered the issue.[12]

Both in order to resolve this conflict, and to eliminate this discrimination, this Court should grant certiorari.

III. The Decision Below Conflicts With the Decision in *Kaiser Steel Corp. v. United States.*

Treas. Regs. 1.613-4(e)(2) provides, *inter alia*, that in computing a representative field or market price from sales made by other miners in a taxpayer's market area, appropriate adjustments must be made to take into account differences in mode of transportation and distance. In *Kaiser Steel Corp. v. United States*, 411 F. 2d 335 (9th Cir. 1969), the court held that the focal point for applying this regulation was the actual *point of consumption* of the integrated miner-manufacturer. Construing the regulation in the light of the *Cannelton* decision, the court

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10. (Cont'd.)
from those fields to Bellefonte. It is for this reason that Bellefonte consumers, if disintegrated, would be willing and able to pay a substantially higher f.o.b. price for stone produced in Bellefonte as compared to the f.o.b. price obtained in other limestone fields. This in turn would afford a reasonable profit to the mining company which would induce it to extract the stone.

11. See footnote 4, p. 8, *supra*.

12. See, for example, *Virginia Greenstone Co. v. United States*, 308 F. 2d 669, 671, 673 (4th Cir., 1962); *Riddell v. Monolith Portland Cement Co.*, 301 F. 2d 488, 493, 495 (9th Cir., 1962); *Kaiser Steel Corp., supra*, p. 337; *North Carolina Granite Corp.*, 56 T. C. 1281, 1287 (1971); *United States v. Portland Cement Co. v. Utah*, 315 F. 2d 169, 171 (10th Cir., 1963); *United States v. Light Aggregates, Inc.*, 343 F. 2d 429, 431 (8th Cir., 1965); *Standard Lime and Cement Co. v. United States*, 329 F. 2d 939, 946 (Ct. Cl., 1964).

reasoned that if Kaiser Steel was treated as an independent miner selling to its manufacturing alter ego for purposes of determining a constructive sales price, it had a competitive advantage in terms of lower freight charges, since its mine lay closer to its plant treated as a hypothetical customer than did the other potential sellers in its market area. Similarly, Warner urged on cross appeal below (and alternatively in the district court), that if sales of limestone from the Virginia Valley (or production fields other than Bellefonte) to Pittsburgh were appropriate for use in the determination of the f.o.b. price at which Warner would have sold its stone, then in computing a representative field or market price for its stone, it was entitled to a freight adjustment measured from Bellefonte, the actual point of consumption.

The court below sought to distinguish *Kaiser* on the ground that Warner's potential market area included Pittsburgh and that it had no freight advantage on sales to this market.[13] However, the conclusion of the court of appeals that Pittsburgh was within Warner's market area, a holding contrary to the findings of the district court, is irrelevant to the application of *Kaiser*. The court below lost sight of the fact that the object is to determine a con-

13. The court below also appears (A24, fn. 17) to have considered *Kaiser* distinguishable on the questionable grounds that the regulations interpreted by Kaiser were not in issue in this case and because Kaiser's mining and manufacturing facilities were geographically separated.

The Regulations interpreted by *Kaiser* were Treas. Regs. 1.613-3(e)(2) which are identical to and succeeded by Treas. Regs. 1.614-3(e)(2) which have been at issue at all stages of this case. Moreover, the *Kaiser* decision clearly did not turn on the fact that the mining and manufacturing facilities were geographically separated but rather the determinative factor was that Kaiser mining was closer (in terms of freight charges) to Kaiser manufacturing than the non-integrated miners in its market area. The application of the Treas. Regs. 1.614-3(e)(2) was not predicated on the geographical separation of the mining and manufacturing components except to the extent it served to measure the freight differential adjustment.

structive sales price for stone actually consumed in Bellefonte.

The *Cannelton* decision and its progeny are consistent in viewing the hypothetical purchaser as the actual consumer of the stone, albeit as a disintegrated entity. Thus, even if, *arguendo,* Pittsburgh is assumed to be within the broad parameters of Warner's hypothetical market area, this is only relevant to determine whether or not competitive sales exist *at all.* If it should be found that they do exist, the regulations, as interpreted by *Kaiser,* require that in order to be "representative" such sales prices must be adjusted to take into account any competitive freight advantage the integrated miner has to the point of actual consumption—in this case to Bellefonte.

This conflict between Circuits in the construction and application of important Treasury Regulations presents a continuing problem in the administration of the tax laws which only this Court can correct.

IV. The Proper Administration of the Federal Tax Laws Requires This Court to Review the Decision Below.

The erroneous decision of the court of appeals in this case substantially affects the administration of justice in tax cases. The court below failed to recognize that its decision resulted in a gross tax inequity which finds no support in the Internal Revenue Code or Regulations and conflicts with this Court's decision in *Cannelton.* The Commissioner's position, as sanctioned by the Court, discriminated against Warner and favored its direct competitors.

During the years at issue, Warner's principal competitors at Bellefonte, National Gypsum and Standard Lime, claimed, and, after examination by the Internal Revenue Service, were allowed depletion on the basis of the proportionate profits method, whenever it was claimed. By re-

stricting Warner to the representative field or market price method, the court below has sanctioned active discrimination against Warner by the Internal Revenue Service.

The cases are clear that there must be an equality of treatment between taxpayers similarly situated. Justice Frankfurter, concurring in *United States v. Kaiser,* 363 U. S. 299, 308, articulated the rule as follows:

> "The Commissioner cannot tax one and not tax another without some rational basis for the difference. And so, assuming the correctness of the principle of equality, it can be independent grounds of decision that the Commissioner has been inconsistent without much concern for whether we should hold as an original matter that the position the Commissioner now seeks to sustain is wrong."

Moreover, in *Ames v. U. S.,* 330 F. 2d 770, 773 (9th Cir. 1964), the court said:

> "[I]n a government computation of constructive gross income from mining for the purpose of calculating percentage depletion allowance, one competitor ought not receive preferred treatment over another similarly situated."

In rendering its decision, the court below failed to address itself to this issue, although it was properly before it. The Commissioner's evidence failed to establish any rational basis for this differentiation and represents improper administration of the tax laws which should be corrected by this Court.

CONCLUSION.

For the foregoing reasons it is urged that this petition for a writ of certiorari be granted.

Respectfully submitted,

WILLIAM T. COLEMAN, JR.,
JULES I. WHITMAN,
ROBERT W. MARIS,
PETER J. PICOTTE, II,
2600 The Fidelity Building,
Philadelphia, Pennsylvania. 19109
Attorneys for Petitioner,
Warner Company.

Of Counsel:
DILWORTH, PAXSON, KALISH
LEVY & COLEMAN,
2600 The Fidelity Building,
Philadelphia, Pennsylvania. 19109

APPENDIX A.

Regulations.

Sec. 1.613-4. *Gross Income From the Property in the Case of Minerals Other Than Oil and Gas.*

• • •

(c) *Cases where a representative market or field price for the taxpayer's ore or mineral can be ascertained*—(1) *General rule.* If the taxpayer processes the ore or mineral before sale by the application of nonmining processes (including nonmining transportation), or uses it in his operations, gross income from mining shall be computed by use of the representative market or field price of an ore or mineral of like kind and grade as the taxpayer's ore or mineral after the application of the mining processes actually applied (if any), including mining transportation (if any), and before any nonmining transportation, subject to any adjustments required by paragraph (e)(1) of this section. See paragraphs (e)(2)(i) of this section for certain other situations in which this paragraph shall apply. The objective in computing gross income from mining by the representative market or field price method is to ascertain, on the basis of an analysis of actual competitive sales by the taxpayer or others, the dollar figure or amount which most nearly represents the approximate price at which the taxpayer, in light of market conditions, could have sold his ores or minerals if, prior to the application of nonmining processes, the taxpayer had sold the quantities and types of ores and minerals to which he applied nonmining processes. If it is possible to determine a market or field price under the provisions of this paragraph, and if that price is determined to be representative, the taxpayer's gross income

from mining shall be determined on the basis of that price and not under the provisions of paragraph (d) of this section. The taxpayer's own actual sales prices for ores or minerals of like kind and grade shall be taken into account when establishing market or field price, provided that those sales are determined to be representative.

(2) *Criteria for determining whether an ore or mineral is of like kind and grade as the taxpayer's ore or mineral.* An ore or mineral will be considered to be of like kind and grade as the taxpayer's ore or mineral if, in common commercial practice, it is sufficiently similar in chemical, mineralogical, or physical characteristics to the taxpayer's ore or mineral that it is used, or is commercially suitable for use, for essentially the same purposes as the uses to which the taxpayer's ore or mineral is put. * * *

* * *

(3) *Factors to be considered in determining the representative market or field price for the taxpayer's ore or mineral.* In determining the representative market or field price for the taxpayer's ore or mineral, consideration shall be given only to prices of ores or minerals of like kind and grade as the taxpayer's ore or mineral and with which, under commercially accepted standards, the taxpayer's ore or mineral would be considered to be in competition if it were sold under the conditions described in paragraph (b)(1) of this section. A weighted average of the competitive selling prices of ores or minerals of like kind and grade as the taxpayer's, beneficiated only by mining processes, if any, in the relevant markets, although not determinative of the representative market or field price, is an important factor in the determination of that price. The taxpayer's own competitive sales prices for minerals which have been subjected only to mining processes shall be taken into account in computing such a weighted average. For purposes

of the preceding sentence, if the district director has exercised his authority under section 482 and the regulations thereunder and has determined the appropriate price with respect to specific sales transactions by the taxpayer, that price shall be deemed to be a competitive sales price for those transactions. Sales or purchases, including the taxpayer's, of ores or minerals of like kind and grade as the taxpayer's, will be taken into consideration in determining the representative market or field price for the taxpayer's ore or mineral only if those sales or purchases are the result of competitive transactions. The identity of the taxpayer's relevant markets (including their accessibility to the taxpayer), and the representative market or field price within those markets, are necessarily factual determinations to be made on the basis of the facts and circumstances of each individual case. For the purpose of determining the representative market or field price for the taxpayer's ore or mineral, exceptional, insignificant, unusual, tie-in, or accommodation sales shall be disregarded. Except as provided above, representative market or field prices shall not be determined by reference to prices established between members of a controlled group. * * *

* * *

(d) *Cases where a representative market or field price cannot be ascertained*—(1) General rule. (i) If it is impossible to determine a representative market or field price as described in paragraph (c) of this section then, except as provided in subdivision (ii) of this subparagraph, gross income from mining shall be computed by use of the proportionate profits method as set forth in subparagraph (4) of this paragraph. * * *

* * *

(4) *Proportionate profits method.* (i) The objective of the "proportionate profits method" of computation

is to ascertain gross income from mining by applying the principle that each dollar of the total costs paid or incurred to produce, sell, and transport the first marketable product or group of products (as defined in subdivision (iv) of this subparagraph) earns the same percentage of profit.

(6) *Method using prices outside the taxpayer's market.* Under the "other market method" the taxpayer uses representative market or field prices established outside his markets, provided that conditions there are substantially the same as in his markets. For example, it may be appropriate in a particular case to establish the representative market or field price for pellets containing 60 percent iron which are produced and used in market area X by reference to the representative market or field price for pellets containing 60 percent iron which are produced and sold in adjacent market area Y, provided that conditions in the two marketing areas are shown to be substantially the same.

(e) *Reductions of sales price in computing gross income from mining.*

* * *

(2) *Purchased transportation to the customer.* (i) A taxpayer who computes gross income from mining under the provisions of paragraph (c) of this section and who sells his ore or mineral after the application of only mining processes but after nonmining transportation shall use as the representative market or field price his delivered price (if otherwise representative) reduced by costs paid or incurred by him for purchased transportation to the customer as defined in subdivision (iii) of this subparagraph. If the transportation by the taxpayer is not purchased transportation to the customer, or if the taxpayer does not sell the ore or mineral until after the application of nonmining processes and if other producers in the taxpayer's market-

ing area sell significant quantities of an ore or mineral of like kind and grade after the application of only mining processes but after purchased transportation to the customer, the representative delivered price at which the ore or mineral is sold by those other producers reduced by representative costs of purchsed transportation to the customer paid or incurred by those producers shall be used by the taxpayer as the representative market or field price for his ore or mineral in applying paragraph (c) of this section. Furthermore, appropriate adjustment shall be made to take into account differences in mode of transportation and distance. When applying this subdivision, the representative market or field price so computed shall not exceed the taxpayer's delivered price less his actual costs of transportation to the customer. For purposes of this subdivision, any delivered price shall be adjusted as provided in subparagraph (1) of this paragraph.

(iv) The provisions of this subparagraph may be illustrated by the following examples:

Example (2). B is engaged in the mining of an ore of mineral N and in the production of N concentrate. B retained all but an insignificant amount of his concentrate for use in his own nonmining operations. Other producers in B's marketing area sell significant amounts of N concentrate of like kind and grade, both on an f.o.b. mine or plant basis and on a delivered basis. In this case, the prices for both the f.o.b. and the delivered sales made by other producers (after any adjustments required by subparagraph (1) of this paragraph), after reduction of the delivered prices by the cost of purchased transportation to the customer, shall, if such prices are otherwise representative, be taken into account in establishing the representative market or field price for the N concentrate produced and used by B.

APPENDIX B.

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

Nos. 73-1722 and 73-1723

WARNER COMPANY,
Appellee in No. 73-1723,
Cross-Appellant in No. 73-1722

v.

UNITED STATES OF AMERICA,
Appellant in No. 73-1723,
Cross-Appellee in No. 73-1722

(D. C. Civil Action No. 255-37)

APPEAL FROM THE JUDGMENT OF THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF PENNSYLVANIA

Argued April 4, 1974
Before: VAN DUSEN, WEIS and GARTH, *Circuit Judges.*

Opinion of the Court.

(Filed September 27, 1974)

Jules I. Whitman, Esq.
Peter J. Picotte, II, Esq.
Philadelphia, Pennsylvania

Of Counsel:
Dilworth, Paxson, Kalish, Levy &
Coleman, Esqs.
Attorneys for Warner Company

Scott P. Crampton, Esq.
Assistant Attorney General,
Meyer Rothwacks, Esq.
Jonathan S. Cohen, Esq.
Donald H. Olson, Esq.
Tax Division, Department of Justice
Washington, D. C.

Of Counsel:
Robert E. J. Curran, Esq.
United States Attorney.
Attorneys for United States of America

GARTH, *Circuit Judge*

Warner Company (Warner) brought this action for a refund of federal income taxes alleged to have been erroneously paid for the taxable years 1956 through 1959 and 1961.[1] From a judgment in favor of the taxpayer, the Government appeals.[2] The issue presented is whether Warner is entitled to employ the "proportionate profits" method of computing its percentage depletion allowance of limestone. The resolution of that issue depends upon whether a "representative market or field price" existed for Warner's limestone.

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1. Jurisdiction existed in the district court under 28 U. S. C. § 1346(a)(1). Our jurisdiction exists by virtue of 28 U. S. C. § 1291.

2. Warner Company filed a cross-appeal, No. 73-1722, asserting that in the event a representative market or field price is found to exist, that price should be adjusted by the cost of transportation of limestone to Bellefonte. We treat this issue at page A23, *infra*.

The district court concluded that "there [was] no representative field or market price for kilnstone [limestone] produced by Warner Company at Bellefonte, during the years involved. It follows, therefore, that plaintiff, Warner Company, must compute its depletion base, 'gross income from the property' for its Bellefonte mine, by reference to the proportionate profits method of computation." [2A] We disagree with the district court, and reverse.[3]

I.

Under 26 U. S. C. §§ 611 and 613,[4] taxpayer claims it is

2A. The determination of a representative market or field price is one of fact. Ames v. United States, 330 F. 2d 770 (9th Cir. 1964), subject to the clearly erroneous standard. Commissioner of Internal Revenue v. Duberstein, 363 U. S. 278 (1960). Applying that standard, we conclude that the district court erred.

3. In an action for a refund of federal income taxes allegedly erroneously paid, the burden is upon the taxpayer to prove that a representative market or field price does not exist. Alabama By-Products Corp. v. Patterson, 258 F. 2d 892 (5th Cir. 1958), *cert. denied* 358 U. S. 930 (1959). Warner failed to discharge its burden of proving by a fair preponderance of the evidence that there was no representative market or field price of limestone of like kind and grade.

4. 26 U. S. C. §§ 611 and 613 provide in pertinent part:

SEC. 611. ALLOWANCE OF DEDUCTION FOR DEPLETION.

(a) *General Rule.*—In the case of mines, oil and gas wells, other natural deposits, and timber, there shall be allowed as a deduction in computing taxable income a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case; such reasonable allowance in all cases to be made under regulations prescribed by the Secretary or his delegate. . . .

. . .

SEC. 613. PERCENTAGE DEPLETION.

(a) *General Rule.*—In the case of the mines, wells, and other natural deposits listed in subsection (b), the allowance for depletion under section 611 shall be the percentage, specified in subsection (b), of the gross income from the property excluding from such gross income an amount equal to any rents or royalties paid or incurred by the taxpayer in respect of the property. Such allowance shall not exceed 50 percent of the taxpayer's taxable

entitled to a percentage depletion allowance of its gross income from mining its limestone. The regulations promulgated thereunder provide, among other things, that if the mined product is processed (as this limestone was processed into calcined lime) before it is sold by the taxpayer, the gross income from the mining of the mineral is to be constructively computed.[5] Under Treasury Regulation § 1.613-4,[6] this is to be accomplished by determining the "representative market or field price" as of the date of the taxpayer's sale of the processed product, of a mineral of like kind and grade, if there is such a representa-

4. (Cont'd.)
income from the property (computed without allowance for depletion). . . .

. . .

(c) *Definition of Gross Income from Properly.*—For purposes of this section—

(1) *Gross income from the property.*—The term "gross income from the property" means, in the case of a property other than an oil or gas well, the gross income from mining.

(2) [as amended by Sec. 302(b)(1), Public Debt and Tax Rate Extension Act of 1960, P. L. 86-564, 74 Stat. 290] *Mining.*—The term "mining" includes not merely the extraction of the ores or minerals from the ground but also the treatment processes considered as mining described in paragraph (4) (and the treatment processes necessary or incidental thereto), and so much of the transportation of ores or minerals (whether or not by common carrier) from the point of extraction from the ground to the plants or mills in which such treatment processes are applied thereto as is not in excess of 50 miles unless the Secretary or his delegate finds that the physical and other requirements are such that the ore or mineral must be transported a greater distance to such plants or mills.

5. Constructive gross mining income is the amount which would have been earned if the miner-manufacturer were "disintegrated" and the raw materials were sold by its mining division as a separate entity. United States v. Cannelton Sewer Pipe Co., 364 U. S. 76 (1960).

6. Appendix I sets out the pertinent provisions of the Treasury Regulation.

tive market or field price. This regulation further provides that if there is no such representative market or field price, the gross income is to be computed by what is commonly called the proportionate profits method.[7] The regulation, however, does not permit the taxpayer to browse freely through these various methods and select the one most favorable to it. The representative market or field price method is the only one available unless the taxpayer establishes that there is no such price. *Ames, supra.* Only then is the proportionate profits method available to it. If a representative market or field price is established and it is less than the taxpayer's mining costs, no deduction is allowed. *United States v. Cannelton Sewer Pipe Co., supra.* This is so because 26 U. S. C. §613(a) expressly limits the percentage depletion allowance to a maximum of 50% of the taxpayer's taxable income from mining. If costs are higher than the selling price, there can be no income. Without income, there can be no depletion allowance under this section of the statute.

II.

The district court's findings of fact reveal the following. During the years in question, taxpayer, a Delaware corporation, was an integrated miner-manufacturer of limestone into lime with facilities located at Bellefonte, Pennsylvania. Virtually all of the limestone, the mined product, that taxpayer mined was converted by it to lime. Limestone has two very broad types of uses. One is for the physical functions that the limestone performs and the second is for its chemical properties. The latter limestone, kilnstone or

7. Regulation § 1.613-4 also provides that if the taxpayer establishes to the satisfaction of the commissioner that another method of computation, other than the computation of profits, proportionate to costs, clearly reflects the gross income from the property then such method of computation may be employed.

fluxing stone,[8] is used both in the lime producing industry and in the steel industry and is the type of limestone mined by taxpayer. It is a high quality, high calcium grade of limestone having a calcium carbonate content of 97.8%.

In extracting limestone from its mine, taxpayer employed the relatively expensive stope method of mining.[9] As a result, it incurred mining costs in excess of $2.00 per ton. Employing this method, during the years in question, taxpayer extracted between 387,794 and 569,914 net tons of limestone each year. Of these, between 293,794 and 439,572 net tons of limestone were consumed in its lime kilns each year. Although taxpayer's business was selling lime, it did sell small amounts of raw limestone. The price at which these sales were made was $2.00 per ton and they were accommodation sales made to obtain the good will of the purchasers.

During the period 1956 to 1961, National Gypsum Company and Standard Lime and Cement Company were taxpayer's principal competitors in the production of lime in the Bellefonte area and, like taxpayer, were integrated miner-manufacturers. Both of these companies mined the same kind and grade of limestone as taxpayer and incurred mining costs approximating taxpayer's. National Gypsum sold no raw limestone although a potential market for its limestone did exist at Pittsburgh (Finding No. 32); Standard Lime made annual sales of stone to various steel companies approximating 10,000 to 15,000 net tons per year at an f.o.b. quarry price of $1.75 per ton. Although these

8. This stone is also called "open hearth" stone or "blast furnace" stone.

9. The stope method of mining for the extraction of ore is an underground steplike excavation carried on either above or below the level where the mass of ore is broken in successive layers. See Creede United Mines Co. v. Hawman, 23 Colo. App. 125, 127 P. 924, 926 (1912); Webster's Third New International Dictionary 2251 (1966).

were accommodation sales, the district court specifically found that the "accommodation nature of these sales had no bearing on the price charged, and Standard Lime priced this flux stone so that it was delivered at a competitive price". (Finding No. 41)

In addition to the above two companies, two other companies produced limestone in the Bellefonte area, Whiterock Quarries and Valley View Lime Company (also referred to as Valley View Quarries). Both of these companies produced the same quality limestone as the integrated miner-manufacturers; however, they sold their limestone on the open market, largely to steel companies in Pittsburgh and Youngstown, Ohio, at prices ranging from $1.55 to $1.74 per ton. During the years in question, neither of these companies sold any limestone to the three Bellefonte lime producers. Whiterock and Valley View, during these years, produced a total of about 515,108 tons of limestone as compared to approximately 7,019,485 tons produced by the three integrated miner-manufacturers. Over the six-year period, the total amount of tons of high quality, high calcium stone produced by Whiterock and Valley View was 7.3% of the total net tonnage of kilnstone produced by taxpayer, National Gypsum and Standard Lime. However, with regard to taxpayer alone, the total production of Whiterock and Valley View averaged 25.7% of the kilnstone produced by taxpayer. (Findings Nos. 47, 48, 49, 52, 55-57).

Bellefonte is located in the center of a high-calcium limestone producing area stretching from Virginia and West Virginia to the south, to other limestone deposits in Pennsylvania and to deposits near Lake Erie in Michigan. At least five producers of limestone of like kind and grade to that of taxpayer's sold vast quantities of blast and open hearth stone to steel producing and lime-making companies

in Pittsburgh, Johnstown and Bethlehem, Pennsylvania.[9a] This is the same market in which both Whiterock and Valley View competed. These sales, f.o.b. mine or quarry, ranged from $1.46 to $1.85 per net ton and for sales from Michigan, they varied from $.85 to $.94 per net ton.[10] No sales were found at or above $2.00 per ton.[11]

III.

The district court's determination that no representative market or field price existed for Warner's limestone was based on (1) Warner's unwillingness to sell its stone in the limestone market as it could not do so profitably, (2) Warner's status as an integrated miner-manufacturer, and (3) Warner's "unique" situation geographically. While each of these factors may be important to the manner in which Warner conducts its business, factors (1) and (2) are not to be taken into account in determining whether a representative market or field price exists, and the third factor relied on by the district court, while relevant, cannot standing alone support the determination reached.

9a. Findings of Fact Nos. 60 and 61 are as follows:

60. The principal areas of high calcium limestone consumption in Pennsylvania, Virginia and West Virginia during the years involved were Pittsburgh, Pennsylvania, Bellefonte, Pennsylvania and Bethlehem, Pennsylvania.

61. Various companies producing high calcium limestone in the Virginia Valley area sold principally to steel companies in the greater Pittsburgh district. High calcium limestone producers located at or near Annville, Pennsylvania, sold their limestone eastward to steel companies located in Eastern Pennsylvania, principally Bethlehem.

10. Neither the government nor the district court considered the Michigan sales in determining whether a representative market or field price existed because these sales were substantially lower in price and deemed unrepresentative.

11. *See* Appendix II for district court Findings of Fact 64-68 inclusive bearing on sales prices.

A. PROFITABILITY

The district court concluded that the representative market or field price, if there was one, would have to be determined by looking at Bellefonte only, reasoning that:

> [B]ecause the direct and indirect mining costs for Warner Mining Company were over $2.00 per ton, Warner Mining Company would not attempt to sell its stone to the Pittsburgh and Eastern Pennsylvania (Bethlehem) market areas assuming it could only obtain a maximum price, f.o.b. Bellefonte, of $1.76 or less per ton, nor would it attempt to sell stone to Warner Manufacturing Company at such price. . . .
>
> This court is of the opinion that the market or field price must exist at Bellefonte if it exists at all and that prices from other markets are not relevant to establish the existence of a price at Bellefonte.
>
> Bellefonte is a distinct limestone field area and market which exists as a lime producing center and not as a limestone-fluxstone producing center . . . . To establish a representative market or field price for Warner's limestone, we must limit the market to one in which the *taxpayer would have and could have completed* in order to obtain a price which is in fact representative . . . . The "market" or "field" concept is an economic concept which necessarily assumes the presence of actual competition. (emphasis supplied)

The district court's reasoning and conclusion *are* at odds with the Supreme Court's decision in *United States v. Cannelton Sewer Pipe Co., supra.*

In *Cannelton* the Supreme Court specifically disapproved of the use of the profitability test in determining depletion allowances stating:

[T]his indicates that fire clay and shale were "commercially marketable" in their raw state *unless that phrase also implies marketability at a profit. We believe it does not.* Proof of these sales is significant not because it reveals an ability to sell profitably—which the respondent could not do—but because the substantial tonnage being sold in a raw state provides conclusive proof that, when extracted from the mine, the fire clay and shale are in such a state that they are ready for industrial use or consumption—in short, they have passed the "mining" state on which the depletion principle operates. It would be strange, indeed, to ascribe to the Congress an intent to permit each miner to adopt processes peculiar to his individual operation. *Depletion, as we have said, is an allowance for the exhaustion of capital assets. It is not a subsidy to manufacturers or the high-cost mine operator. The value of respondent's vitrified clay products, obtained by expensive manufacturing processes, bears little relation to the value of its minerals. The question in depletion is what allowance is necessary to permit tax-free recovery of the capital value of the minerals.*

Respondent insists that its miner-manufacturer status makes some difference. We think not. It is true that the integrated miners in Indiana outnumbered the nonintegrated ones. But in each of the three basic percentage depletion Acts the Congress indicated that integrated operators should not receive preferred treatment. Furthermore, in Regulations 77, discussed above, the Treasury specifically provided that depletion was allowable only on the crude mineral product. And, as we have said, this regulation was substantially enacted into the 1943 Act. We need not tarry to deal with any differences which are said to have existed in admin-

> istrative interpretation, for here we have authoritative congressional action itself. Ever since the first percentage depletion statute, the cut-off point where "gross income from mining" stopped has been the same, i.e., where the ordinary miner shipped the product of his mine. *Respondent's formula would not only give it a preference over the ordinary nonintegrated miner, but also would grant it a decided competitive advantage over its nonintegrated manufacturer competitor. Congress never intended that depletion create such a discriminating situation.* As we see it, the miner-manufacturer is but selling to himself the crude mineral that he mines, insofar as the depletion allowance is concerned. (emphasis supplied)

364 U. S. at 86-87, and *see* 89 n. 10. The Supreme Court stressed that depletion was designed not to compensate for costs of recovery but for exhaustion of mineral assets alone. *See also Kaiser Steel Corp. v. United States,* 411 F. 2d 335 (9th Cir. 1966); *Dravo Corp. v. United States,* 348 F. 2d 542 (Ct. Cl. 1965); *Virginia Greenstone Co. v. United States,* 308 F. 2d 669 (4th Cir. 1962); *United States v. Henderson Clay Products,* 324 F. 2d 7 (5th Cir. 1963); *Riddell v. Victorville* Lime Rock Co., 292 F. 2d 427 (9th Cir. 1961); and *United States v. Pacific Clay Products,* 285 F. 2d 215 (9th Cir. 1960). Thus, the district court here erred in considering profitability as a factor in the determination of a representative market or field price. As the court in *Kaiser Steel Corp., supra,* noted:

> Neither Utah Fuel's nor Kaiser's sales can be extracted from the relevant market data on the ground that the sales were not profitable or that they were not as profitable as they would have been under different market conditions. The existence of a representative field prices does not turn on how profitable the sales

> may be. It is true that a market may disappear altogether if producers continually lose money, but so long as there are producers in the market in open competition, a market there will be.

411 F. 2d at 342. *See also Shamrock Oil & Gas Corp.*, 35 T. C. 979 (1961).

B. Integrated Miner-Manufacturer

The district court assigned substantial weight to Warner's status as an integrated miner-manufacturer as its second factor in the determination of the area in which the market or field price must exist. It held that:

> [T]he market area of an integrated miner-manufacturer, such as Warner Company, is the area in which it extracts and converts its mineral into its manufactured product. (Conclusion of Law No. 9)

We disagree.

To adopt such a broad principle as enunciated by the district court would permit integrated miner-manufacturers to establish by their own acts in the location of their facilities the existence of a representative market or field price. If we were to subscribe to the district court's reasoning, all that would be required to avoid using the representative market or field price method would be to establish an integrated mining-manufacturing plant slightly apart from others and consume all of the raw material produced there. *Cannelton's* teachings dictate against the adoption of such a principle.

While an integrated miner-manufacturer should be regarded as if the mining half were selling to the manufacturing half,[12] this does not mean that the price at which

12. United States v. Cannelton Sewer Pipe Co., *supra*.

the mining half would sell the raw product to the manufacturing half is controlling. Rather, the standard for determining whether a representative market or field price exists is that of actual competitive sales. The test to be employed is whether or not there have been recent, substantial sales of limestone similar to taxpayer's in quality and availability to market, and if so, at what price were those sales made? *Phillips Petroleum Co. v. Bynum,* 155 F. 2d 196, 198 (5th Cir. 1946).[13] Restated, the inquiry is the price a consumer would pay for the raw mineral mined by the mining "half". It is not what the manufacturing "half" would pay for the comparable raw mineral.

> The proper gross income is that which the hypothetical mining entity would realize upon selling its products to its processing alter-ego. The need for this constructive disintegration is emphasized by the strong desire to afford no unfair tax advantage to the integrated producer vis-a-vis the non-integrated miners and manufacturers. *The representative price is then the competitive going price for the product, i.e., the price charged by the taxpayer's competitors.* (emphasis added).

United States v. Henderson Clay Products, 324 F. 2d 7, 15 (5th Cir. 1963).

C. Geographic Factor

In its discussion, the district court stated that Bellefonte is a distinct market "which exists as a lime producing center and not as a limestone-fluxstone producing center." Further, the district court found as a fact that the target market for any limestone mined by Warner could

13. *See* Appendix I, Treas. Reg. § 1.613-4(c)(3) for those factors to be considered in determining the existence of a representative market or field price.

only be Bellefonte because Bellefonte was the "site of its [Warner's] manufacturing facilities." (Findings Nos. 75, 76).

Reviewing these findings, the district court clearly erred. It is irrelevant whether Bellefonte exists as a *lime* producing center. The relevant inquiry, (*see Cannelton, supra*), is whether a representative market or field price for a mined product (in this case, *limestone*) exists. As such, the question is whether there exists a substantial market in which taxpayer, had it been solely engaged in mining, could have sold its raw limestone. Our inquiry then *cannot* be limited solely to the geographic locale of the *manufacturing* facilities of the integrated miner-manufacturer as the district court found. In *Cannelton, supra,* the Supreme Court found a relevant market approximately 140 miles from the site of the integrated miner-manufacturer. In *Kaiser Steel Corp., supra,* the court considered the entire western part of the United States. In *Virginia Greenstone Company v. United States, supra,* the court considered the entire state of Virginia and part of Kentucky. *See also Panhandle Eastern Pipe Line Co. v. United States,* 408 F. 2d 690 (Ct. Cl. 1969); *Hugoton Production Co. v. United States,* 349 F. 2d 418 (Ct. Cl. 1965). One circuit has approved a representative market and field price which was determined by reference to the industry wide grading and pricing system:

> [T]he district court found that the taxpayer could properly rely on the industry-wide grading and pricing system to establish representative prices for the limestone shipped to its mills. . . .
>
> • • •
>
> Thus the courts have allowed neither physical characteristics nor end use nor conditions of marketing to narrow the class of products to be used in reaching

comparative prices. The district court was correct in finding the existence of a well-established representative market or field price for taxpayer's rough block limestone.

Bloomington Limestone Corp. v. United States, 445 F. 2d 1105, 1107, 1108 (7th Cir. 1971).

Thus, we hold that the district court erred in restricting its inquiry as to "market" to Warner's manufacturing situs and Bellefonte.

IV.

Contrary to the district court's conclusion, our review of that court's Findings of Fact and discussion demonstrates that there did exist a representative market or field price.[14] Indeed, in the instant case, the district court found that a market for limestone of like kind and grade as taxpayer's limestone existed at Pittsburgh (which is approximately 130 miles from taxpayer) and other areas adjacent

14. In normal course our holding that the district court erred in not finding a representative market or field price would generally require a remand to the district court for a determination of what that representative market or field price is. We need not remand here in light of the record and the issue presented to us. We are concerned only with the question of representative market or field price as it relates to the depletion allowance. As previously noted, depletion allowance is permitted only from income, i.e., when the sales price exceeds cost (of mining). The district court's Findings of Fact demonstrate beyond question that not only did Warner's costs exceed any competitive price it could have received from the sale of its limestone, but Findings Nos. 80 and 81 recite that Warner would not sell any of its limestone at less than its cost of $2.00 per ton. The district court has made Findings of Fact (which it ignored in formulating its conclusion) as to competitive sales prices of limestone in the greater Pittsburgh area and elsewhere, and in each instance the price was below $2.00. (Finding of Fact No. 81 assumes a maximum price f.o.b. Bellefonte of $1.76 or less per ton). There being no possibility of any depletion allowance available to Warner within a relevant market (i.e., a market not restricted to Bellefonte) based on a $2.00 cost, on this record, we find it unnecessary to remand.

to Bellefonte.[15] The district court failed to give appropriate significance to this finding; because of the undue weight given to taxpayer's unwillingness to participate in such a market absent assurances of profitability in sales, (*see* III A. *supra*) and to taxpayer's status as an integrated miner-manufacturer, (*see* III E. *supra*).

Expanding our examination of "market" beyond the boundaries of Bellefonte, we note that no price for limestone was found by the district court at or above the price of $2.00 per ton in the relevant market, including the greater Pittsburgh area. While the sale of raw limestone f.o.b. Bellefonte, were small in comparison to the total amount mined and consumed in Bellefonte by Warner, nevertheless they were made at competitive prices ($1.55-$1.75). The district court specifically found in the case of Standard Lime which had made accommodation sales to its good customers, that

* * *

> ". . . 41 The accommodation nature of these sales had no bearing on the price charged, and Standard Lime priced this fluxstone so that it was delivered at a competitive price."

Although the district court described the Valley View and Whiterock production as being insignificant, the combined production of Valley View and Whiterock, when compared to the taxpayer's production of limestone during 1956-1961, averaged 25.7% of Warner's production. Moreover, these sales were made at a price (Whiterock $1.61-$1.74; Valley View $1.55-$1.60) in the range of the price charged by

15. Valley View, Whiterock and Standard Lime, all located in Bellefonte, sold raw limestone in Pittsburgh and adjacent areas, as did limestone producers located in West Virginia, Virginia, Michigan and other areas in Pennsylvania.

Standard Lime ($1.75) which latter price the district court found to be competitive.[16]

The district court in its discussion recognized that there was a market for limestone at Pittsburgh, at Bethlehem, at Chicago, at Detroit and "all over" the United States, but not for Warner's limestone. It reasoned that Warner could have sold its limestone anywhere but only if Warner's price was competitive. The difficulty with this reasoning is that Warner's profit desires may not legitimately be considered in the context of determining a representative market or field price or in determining depletion allowance. *See United States v. Cannelton Sewer Pipe Co., supra,* 364 U. S. at 86-87.

At the outset, we noted that Warner had the burden of proving that no representative market or field price existed. Inasmuch as we reject Warner's theories (1) that profitability must be present in determining the representative market or field price, and (2) that Warner should be accorded a unique status as a miner-manufacturer within a "market" restricted to Bellefonte alone, we can discern no other basis on which Warner has met its requisite burden.

We hold, therefore, that a representative market or field price existed in at least the greater Pittsburgh area,

16. We recognize the distinction made in the regulations with respect to accommodation sales. Yet, as we note in the text, the district court found that the accommodation nature of the sales did not prevent consideration of them for market price purposes.

As was stated in Alabama By-Products Corp. v. Patterson, 258 F. 2d 892, 899 (5th Cir. 1958), *cert. denied,* 358 U. S. 930 (1959):

> Although the sales made by the taxpayer were in the nature of "forced" sales owing to peculiar economic conditions, the sales of coking coal by the other companies were the natural result of competitive bargaining, and principles of supply and demand. This is enough to create a true market in commerce. (footnotes omitted)

See also, Ames, supra; Riverton Lime and Stone Co. v. C. I. R., 28 T. C. 441 (1957) (where the court allowed a sales price in a restricted number of sales to stand as a representative market or field price).

including Bellefonte, for the years involved, and that Warner has failed to carry its burden to prove otherwise.

Warner alternatively urges in its cross appeal that if a representative market or field price exists (as we hold that it does), that adjustments should be made for freight costs. Warner states this position as:

> [I]f it is established that any of the prices of the fluxstone produced outside the Bellefonte area and sold to certain consumption areas outside the Bellefonte area establish a basis for the determination of a field or market price . . . for Warner's kilnstone, then, to establish a representative field or market price for Warner's kilnstone mined and used at Bellefonte, such unadjusted price must be adjusted by increasing it by the freight differential which would exist due to the additional cost of shipment from such other producing area to Bellefonte.

Brief for Warner in No. 73-1723 at p. 32.

Having considered the arguments advanced by Warner in support of its position, we find them without merit.[17]

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17. Although this issue was raised in the district court, that court's finding (that no representative market or field price existed) obviated any necessity for that court to rule on Warner's alternative argument. Our holding, reversing the district court on the ground that a representative market or field price did exist, obliges us to consider Warner's alternative contention. Warner's argument is predicated upon the assumption that "[O]nce it is assumed that Bellefonte is Warner's marketing area, then if Virginia Valley [a limestone producing area] is used in the determination of a representative field or market price [sic] it is necessary under the *Kaiser* case [411 F. 2d 335 (9th Cir. 1969)] to adjust for freight differentials to Bellefonte." Reply Brief for Warner in No. 73-1722 at p. 2. Warner's argument founders on the assumption that Bellefonte is Warner's marketing area. Once it is determined that Warner's marketing area cannot be confined to Bellefonte, the argument falls of its own weight. As we have stated, we are concerned here with the price at which Warner's mining "half" could have sold its limestone. We are not concerned with the price that Warner's manufac-

The judgment of the district court will be reversed and the case remanded with the direction that the district court enter judgment for the defendant United States in accordance with the foregoing opinion.

Costs to be borne by each party in No. 73-1723; costs to be taxed against cross-appellant Warner in No. 73-1722.

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17. (Cont'd.)
turing "half" would pay for limestone, whether that limestone was purchased in Bellefonte or purchased from other producing areas and then shipped to Bellefonte. (In this connection, we note that Exhibits P-2 and P-4 demonstrate little disparity in freight rates *from* Bellefonte and other producing areas to *Pittsburgh*).

Warner's reliance upon *Kaiser, supra,* is necessarily misplaced. *Kaiser* interpreted regulations not at issue here and the court in *Kaiser* was concerned with an integrated miner-manufacturer having its mining and manufacturing facilities geographically separated. The circumstances giving rise to freight cost consideration in *Kaiser* are not present here.

APPENDIX I.

Regulation § 1.613-4 in pertinent part provides:

§ 1.613-4 *Gross income from the property in the case of minerals other than oil and gas.*

. . .

(c) *Cases where a representative market or field price for the taxpayer's ore or mineral can be ascertained—* (1) *General rule.* If the taxpayer processes the ore or mineral before sale by the application of nonmining processes (including nonmining transportation), or uses it in his operations, gross income from mining shall be computed by use of the representative market or field price of an ore or mineral of like kind and grade as the taxpayer's ore or mineral after the application of the mining processes actually applied (if any), including mining transportation (if any), and before any nonmining transportation, subject to any adjustments required by paragraph (e)(1) of this section. See paragraph (e)(2)(i) of this section for certain other situations in which this paragraph shall apply. The objective in computing gross income from mining by the representative market or field price method is to ascertain, on the basis of an analysis of actual competitive sales by the taxpayer or others, the dollar figure or amount which most nearly represents the approximate price at which the taxpayer, in light of market conditions, could have sold his ores or minerals if, prior to the application of nonmining processes, the taxpayer had sold the quantities and types of ores and minerals to which the applied nonmining processes. If it is possible to determine a market or field under the provisions of this paragraph, and if that price is determined to be repreentative, the taxpayer's gross income from mining shall be determined on the basis of that price and not under the provisions of para-

graph (d) of this section. The taxpayer's own actual sales prices for ores or minerals of like kind and grade shall be taken into account when establishing market or field prices, provided that those sales are determined to be representative.

. . .

(3) Factors to be considered in determining the representative market or field price for the taxpayer's ore or mineral. In determining the representative market or field price for the taxpayer's ore or mineral, consideration shall be given only to prices, ores or minerals of like kind and grade as the taxpayer's ore or mineral and with which, under commercially accepted standards, the taxpayer's ore or mineral would be considered to be in competition if it were sold under the conditions described in paragraph (b)(1) of this section. A weighted average of the competitive selling prices of ores or minerals of like kind and grade as the taxpayer's, beneficiated only by mining processes, if any, in the relevant markets, although not determinative of the representative market or field price, is an important factor in the determination of that price. The taxpayer's own competitive sales prices for minerals which have been subjected only to mining processes shall be taken into account in computing such a weighted average. For purposes of the preceding sentence, if the district director has exercised his authority under section 482 and the regulations thereunder and has determined the appropriate price with respect to specific sales transactions by the taxpayer, that price shall be deemed to be a competitive sales price for those transactions. Sales or purchases, including the taxpayer's of ores or minerals of like kind and grade as the taxpayer's, will be taken into consideration in determining the representative market or field price for

the taxpayer's ore or mineral only if those sales or purchases are the result of competitive transactions. The identity of the taxpayer's relevant markets (including their accessibility to the taxpayer), and the representative market or field price within those markets, are necessarily factual dterminations to be made on the basis of the facts and circumstances of each individual case. For the purpose of determining the representative market or field price for the taxpayer's ore or mineral, exceptional, insignificant, unusual, tie-in, or accommodation sales shall be disregarded. Except as provided above, representative market or field prices shall not be determined by reference to prices established between members of a controlled group. See paragraph (j) of this section for the definitions of the terms "controlled" and "group".

. . .

(d) *Cases where a representative market or field price cannot be ascertained*—(1) *General rule.* (i) If it is impossible to determine a representative market or field price as described in paragraph (c) of this section then, except as provided in subdivision (ii) of this subparagraph, gross income from mining shall be computed by use of the proportionate profits method as set forth in subparagraph (4) of this paragraph. . . .

. . .

(4) *Proportionate profits method.* (i) The objective of the "proportionate profits method" of computation is to ascertain gross income from mining by applying the principle that each dollar of the total costs paid or incurred to produce, sell, and transport the first marketable product or group of products (as defined in subdivision (iv) of this subparagraph) earns the same percentage of profit . . .

APPENDIX II.

Among other Findings of Fact made by the district court, the following appear with respect to sales prices:

64. The J. E. Baker Company operated a quarry a few miles south of Martinsburg, West Virginia. During the years 1956 through 1961, the Company sold the following tonnages of open hearth, blast furnace and foundry stone for the prices indicated:

Year	*Net Tons Sold*	*Average f.o.b. quarry price (net ton)*
1956	180,518	$1.63
1957	166,469	1.71
1958	152,420	1.74
1959	143,684	1.73
1960	110,053	1.74
1961	56,070	1.62

The vast majority of these tonnages were sold to steel mills in the Pittsburgh area, Youngstown and Weirton, West Virginia areas. . . .

65. The W. S. Frey Company, Inc., operated a limestone quarry at Martinsburg, West Virginia, during the period January 1, 1956 to March of 1961. For the balance of 1961, the Company moved its operation to Clearbrook, West Virginia after selling its Martinsburg plant.

During each of the years 1956 through 1959, W. S. Frey Company sold approximately 150,000 net tons of open hearth limestone. Prices for these sales averaged $1.75 per net ton f.o.b. quarry. The majority of these sales were made to customers in the greater Pittsburgh area. During the years 1956-1959, the Company sold approximately 75,000 net tons of blast furnace stone annually. Prices for this product aver-

aged $1.65 per net ton f.o.b. quarry. The majority of these sales were also made to customers in the greater Pittsburgh area. . . .

During the year 1961, the Company sold some 275,000 net tons of open hearth stone and 84,000 net tons of blast furnace stone. The average f.o.b. quarry price per (net) ton for the open hearth stone ranged from $1.47 to $1.74.

During 1961, the Company sold 9,493 net tons of kilnfeed to the Mercer Lime and Stone Company. The price per net ton was $1.65. This price was set by the Company to sell at the same price as the blast furnace stone price, which was ten cents per ton less than open hearth stone due to its smaller size. The kilnfeed sold to Mercer was 3″ x 5″ in size. Had Frey instead wanted to sell Mercer a kilnfeed sized ½″ x 2″ (which is in the middle of Warner's kilnfeed size spectrum), Frey's president stated that he would have set the price some five to ten cents less than the price of blast furnace stone and kilnfeed, which was $1.65.

The Company sold its open hearth and blast furnace stone to a variety of steel companies located in Pennsylvania, Maryland, Ohio and West Virginia. During the years in suit, the Company considered itself to be in competition for open hearth stone sales in the greater Pittsburgh area with the Valley View Quarries, Bellefonte, Pennsylvania, Thomasville Stone and Lime Company, and several other Virginia and West Virginia limestone operators.

66. The Chemstone Corporation operated a limestone quarry and lime plant in Strasburg, Virginia, during the years 1956-1961. . . .

The average price per (net) ton received by the Company for open hearth stone ranged from $1.54 to $1.74. The average blast furnace price varied from

$1.34 to $1.85. The Company sold its open hearth and blast furnace stone to a large number of customers located in Pennsylvania, Maryland, Ohio, West Virginia, and Michigan.

67. The M. J. Grove Lime Company conducted two limestone operations in Virginia during the years 1956 through 1961—one at Middletown and the other at Stephens City. . . .

During these years, the following average f.o.b. quarry prices were received by the Company:

Year	*Product*	*f.o.b. quarry price (net ton)*
1956	open hearth stone	$1.64-$1.65
	blast furnace stone	
1957	open hearth stone	$1.73-$1.74
	blast furnace stone	1.53- 1.54
	kilnfeed	1.57-
1958	open hearth stone	$1.73-$1.74
	blast furnace stone	1.48- 1.54
	chemical stone	1.80
1959	open hearth stone	$1.73-$1.74
	blast furnace stone	1.54
	chemical stone	1.80
	kilnfeed	1.57
1960	open hearth stone	$1.65-$1.72
	blast furnace stone	1.63- 1.65
	chemical stone	1.80
1961	open hearth stone	$1.70
	blast furnace stone	1.61-$1.65
	kilnfeed	1.61

. . .

The Company's open hearth and blast furnace stone customers were located in the greater Pittsburgh area, and the areas of Wheeling, West Virginia; Bethlehem, Pennsylvania; and Maryland. . . .

68. During all of the years in suit the Mercer Lime and Stone Company (located in Branchton, Pennsylvania, some 50 miles north of Pittsburgh), operated four vertical lime kilns, which used a size 3" x 5" kilnfeed. . . . During the period in suit the tonnages purchased, and the f.o.b., hold of vessel, Port of Calcite, Rogers City prices, were as follows:

Year	*Net Tons Purchased*	*Average price per ton f.o.b., hold of vessel, Port of Calcite, Rogers City, Michigan*
1956	111,402	$.85
1957	113,663	.92
1958	125,787	.94
1959	119,711	.94
1960	154,102	.94
1961	122,236	.94

The chemical quality of this stone was practically identical to Warner's kilnfeed.

APPENDIX C.

IN THE
UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA.

CIVIL ACTION NO. 25537.

WARNER COMPANY

v.

UNITED STATES OF AMERICA

OPINION AND ORDER.

NEWCOMER, *J.* March 28, 1973

Having considered the testimony and evidence introduced at trial, as well as the excellent and extensive briefs and stipulations submitted by both parties and the amicus curiae, the Court makes the following findings of fact pursuant to Federal Rule of Civil Procedure 52(a):

FINDINGS OF FACT.

1. Plaintiff, Warner Company is now, and since and prior to 1956 has been, a corporation organized and existing under the laws of the State of Delaware, with its principal place of business at 1721 Arch Street, Philadelphia, Pennsylvania, within the jurisdiction of this Court.

2. Jurisdiction is founded upon the provisions of Section 1346(a)(1) of Title 28 of the United States Code.

Jurisdiction and venue is properly in the United States District Court for the Eastern District of Pennsylvania. This action is brought against Defendant to recover the following sums assessed and collected from Plaintiff, or such other larger or lesser sums so assessed and collected a the Court may determine to be proper:

Year	*Amount of Tax*	*Amount of Interest Collected*	*Total Tax and Interest*
1956	$162,161.00	$11,266.19	$173,427.19
1957	111,709.00	23,428.17	135,137.17
1958	71,435.53	19,569.40	91,004.93
1959	132,969.00	22,484.21	155,453.21
1961	113,185.00	16,788.95	129,973.95
TOTALS	$591,459.53	$93,536.92	$684,996.45

3. Plaintiff timely filed its income tax returns with the District Director of Internal Revenue at Philadelphia, Pennsylvania and paid the tax shown to be due thereon as follows:

Taxable Year	*Amount of Tax Paid With Return*
1956	$2,039,938.61
1957	1,068,844.51
1958	1,014,619.66
1959	1,244,236.00
1961	832,204.00

4. Deficiencies were assessed against Plaintiff and collected as follows:

Taxable Year	*Date of Payment*	*Amount of Tax*	*Amount of Interest*
1956	1/ 1/61	$154,889.91	$11,266.19
1957	10/ 7/60	51,979.01	8,010.46
	2/28/64	368,133.86	77,207.01
1958	2/ 5/61	—	4,160.84
	4/20/61	36,674.84	291.89
	2/28/64	92,645.69	25,379.84
1959	10/12/61	37,374.79	3,556.84
	2/21/64	88,468.30	18,927.37
1961	10/ 1/65	80,287.83	16,788.95

5. The amount set forth above as a deficiency in tax and interest in respect of 1956 was collected by the Internal Revenue Service through the application of a credit in the aggregate amount of $166,156.10, which credit arose as a result of a net operating loss in the year 1960 which loss was carried back to the year 1957. The said amount of $166,156.10 was a part of the amount that would otherwise have been refunded for 1957, but which was instead applied by the District Director in satisfaction of an asserted deficiency for the year 1956. In respect of the year 1957, there was allowed an aggregate overassessment of $832,346 resulting from the aforementioned net operating loss occurring in 1960.

6. (a) (i) Timely claims for refund for the year 1956 were filed on or about March 12, 1958 and February 15, 1963.

(ii) Plaintiff filed a waiver of statutory notice of claim disallowance in respect of $166,156.10 for the year 1956 on January 13, 1966.

(iii) On or about March 16, 1966, pursuant to a stipulation of the parties, Plaintiff amended its Complaint

previously filed in this action asserting a claim for recovery of said $166,156.10.

(b) (i) Timely claims for refund for the years 1957, 1958, 1959 and 1961 were filed with the District Director of Internal Revenue at Philadelphia, Pennsylvania, on October 8, 1966.

7. No formal action has been taken by the District Director with respect to said claims for the years 1957, 1958, 1959 and 1961 and no notice of disallowance has been issued or waiver of such notice filed.

8. Limestone has two very broad types of uses. One is for the physical functions that the limestone performs. Examples are limestone used for road-building ("roadstone"), and limestone used in beds for railroad tracks ("railroad ballast"). The second major use is for its chemical properties. Lime manufacture is one chemical use of limestone. There are some twenty others. Among these are metallurgical flux, glass manufacture, agricultural limestone and, paper mill stone. The Warner Company, by burning its captive limestone for making lime, was using the stone for one chemical use. Limestone used for burning to make lime is called "kilnstone" or "kilnfeed."

9. Steel companies use chemical grade limestone as a "fluxing" agent in the blast furnace and open hearth stone operations. The industrywide accepted terms follow the use thus, "blast furnace" and "open hearth" stone.

10. The open hearth and blast furnace operations both convert the limestone into lime. Lime manufacture is similar—it applies high heat temperatures to limestone in a kiln, which drives off carbon dioxide, and produces lime. There is the same reaction in the production of iron and steel.

11. Cupola stone, or, foundry stone, is a limestone product used as a fluxing agent in either a cupola, or a foundry, respectively. Kilnfeed, open hearth, blast furnace stone, and cupola stone are homogenous products.

12. Warner is an integrated miner-manufacturer with lime manufacturing facilities located at Bellefonte, Pennsylvania. It mines limestone at Bellefonte and manufactures it into lime and lime products.

13. The Bellefonte operation began about 1901 when the American Lime & Stone Company was formed and commenced quarrying operations at Bellefonte to extract high calcium limestone for calcining into lime. About 1921 or 1922, the quarrying operation was terminated and a mining operation was commenced. In 1922 Charles Warner Company (name later changed to Warner Company) acquired control of American Lime & Stone and in 1944 American Lime & Stone Company ceased to exist and the Bellefonte operation was directly taken over by Warner Company.

14. During the years 1956-1961, the Company extracted from its Bellefonte mine the following quantities of limestone:

Year	*Net Tons*
1956	569,914
1957	475,271
1958	422,326
1959	503,836
1960	387,575
1961	424,711

15. Warner utilized the stope method of mining at its Bellefonte operation. During the years 1956-1961, it was mining at the 600 foot level (below surface). Mining con-

tinued at this level until 1962, when it was dropped to the 960 foot level in March, 1962. Development of this level started in 1954.

16. Generally, the limestone is drilled and blasted free in the stopes, sledge-broken, and transported to the surface by dump cars and a hoisting mechanism. At the surface, the stone, which is a maximum dimension of approximately 12 inches, is put through a primary crushing and then proceeds on a conveyor belt which takes it to the crushing and screening operation which reduces it to a size suitable for kiln feed.

17. Due to the method of mining limestone required at Warner's mine, it was necessary to extract the total tonnages of limestone specified above in order to make available the total tonnages of kiln feed specified hereinafter. Warner was in business at Bellefonte to produce and sell lime and the extraction of the limestone from its mine was an integral part of its lime business.

18. During the period 1956-1961, Warner consumed in its Bellefonte kilns the following net tons of kiln feed extracted from its Bellefonte mine:

Year	*Net Tons*
1956	439,572
1957	355,956
1958	281,209
1959	372,961
1960	283,190
1961	273,794

19. During the period 1956-1961, Warner sold certain limestone products from its Bellefonte plant. However, except for small amounts of crushed stone, all of it was too

small for use as kilnstone for calcining into lime. The sales of crushed stone, which amounted to less than .0205 per cent of the total crushed limestone used by Warner in its kilns, were as follows:

Year	*Tons*	*Price Per Ton*
1956	4,161	$2.01
1957	3,975	2.01
1958	2,715	2.00
1959	3,982	2.00
1960	3,748	2.00
1961	3,442	2.00

20. The majority of the "crushed stone" sales listed above were sales of cupola stone to General Electric Company at Elmira, New York, and Ward Casting Company in Blossburg, Pennsylvania. The balance of the stone was sold to local townships or possibly a small foundry in the immediate area of Bellefonte. This stone was sized ¾" × 2½" and was used for metallurgical purposes. The price at which these sales were made, $2.00 per ton, was not reviewed by Warner Company during the period at issue. The sales were accommodation sales and were made to obtain the good will of the purchasers.

21. The typical chemical analysis for the kiln feed consumed by Warner Co. during the years 1956-1961, as well as for the cupola stone sold by it, was as follows:

Calcium Carbonate ($CaCO_3$)	97.80%
Magnesium Carbonate ($MgCO_3$)	1.10%
Silica (SiO_2)	.75%
Aluminum (Al_2O_3)	.24%
Iron (Fe_2O_3)	.11%

22. During 1956 and 1957, Warner shipped its lime to various users for the following metallurgical and chemical uses:

Use	*1956 Tons*		*1957 Tons*	
Pigment	2,704		1,380	
Agricultural	4,987		4,933	
Building	3,646		8,145	
Steel (Flux)	57,420	26%	42,065	22%
Steel (other)	41,231		37,179	
Paper	58,590	26%	47,899	25%
Tanning	15,457		22,435	
Water	14,943		22,037	
Carbide	1,151		38	
Miscellaneous	23,422		4,768	
	223,541		190,909	

23. The principal uses referred to under "Steel (other)" was for waste treatment, water treatment and possibly wire drawing. Of these, waste treatment was the major category of use. The uses listed under "miscellaneous" included such uses as calcium silica (insolubles), sugar refining, gelatin for food or pharmaceutical use, and phosphate used in the chemical industry.

24. The details for 1958, 1959, 1960 and 1961 are no longer available but the 1956 and 1957 figures are generally typical of the variety of uses of Warner's lime for those years.

25. For 1956-1961 after charging of direct mining expenses and allocation of indirect mining expenses, Warner's cost of mining per net ton of kilnstone was approximately $2.00 per net ton.

26. Warner operated its Bellefonte plant at a net profit in each of the years 1956-1961.

27. The high calcium lime industry is a highly competitive business where quality and uniformity in quality are important factors in determining the marketability of a high calcium lime product. There is no manufacturer of lime in either the Northeastern or Mid-Eastern section of the United States which does not have significant competition in its market area.

28. During the period 1956 to 1961, National Gypsum Company and Standard Lime and Cement Company were Warner Company's principal competitors in the production of lime in the Bellefonte area. National Gypsum Company's mining property abutted Warner Company's although the distance between the openings of their mine shafts was approximately 2 miles. Standard Lime Company was located in Pleasant Gap, approximately 5 to 6 miles south of Warner's operation.

29. National Gypsum employed the stope mining method which was similar to Warner's method, and its costs of extraction were approximately the same as Warner's. It cost National Gypsum about $2.00 a ton to extract limestone at Bellefonte. National Gypsum did not regard itself as being in the limestone business.

30. National Gypsum also extracted limestone at Kimballton, Virginia, and this stone was used to produce high calcium lime. The Kimballton stone was extracted at a lower cost and was chemically and physically suitable for use at Bellefonte for the manufacture of lime, but was too expensive to transport to Bellefonte. Bellefonte and Kimballton sold their limes to different areas to take advantage of the transportation economics.

31. National Gypsum did not sell kilnstone from its Bellefonte operation to the steel companies in the Pittsburgh area or elsewhere. It regarded its kilnstone as prime stone which it refused to sell at the going price for chemical or metallurgical limestone. National Gypsum's price list for Bellefonte did not list high calcium open hearth and blast furnace products, primarily because the Company's cost of extraction of open hearth and blast furnace size stone was greater than the established market price for those products. During the years 1956 to 1961, National Gypsum neither bought nor sold kilnstone in connection with its Bellefonte operation.

32. National Gypsum never had any interest in selling its Bellefonte kilnstone to anyone as fluxstone because its mining cost was greater than the selling price could have been. If National Gypsum got out of the lime business, it would no longer have continued mining at Bellefonte because the price at which National would have had to sell its stone would have resulted in a loss. A potential market for National Gypsum's limestone did exist at Pittsburgh as fluxstone to the steel industry, but if National Gypsum had sold its stone into the Pittsburgh market, it would not have made a profit.

33. In National Gypsum's opinion, limestone which had a calcium carbonate content of less than 95% would not have been used by it and could not compete with lime processed from limestone having a calcium carbonate content greater than 95%.

34. The typical chemical composition of National Gypsum's kilnstone was slightly higher than 97.25-97.35 per cent calcium carbonate. This stone had a magnesium carbonate content of 1.45-1.50 per cent.

35. National Gypsum produced the following tonnages of kilnstone during the years 1956-1961:

Year	*Net Tons Kilnstone*
1956	513,976
1957	469,535
1958	351,492
1959	394,643
1960	402,780
1961	455,863

36. National Gypsum and Warner compete with respect to sales of fluxing lime and chemical lime, and National Gypsum regards Warner as one of its prime competitors.

37. Standard Lime and Cement Company began its Pleasant Gap, Pennsylvania operation in 1950. In that year, it started a limestone mine as well as a supplemental quarry which was used on an occasional basis when there was a need to supplement the mine's production. Pleasant Gap is in the Bellefonte area, and the high calcium limestone produced there is extracted from the Valentine member of the Curtin formation. National Gypsum and Warner Company also mine their high calcium limestone from the Valentine member.

38. Standard Lime began its Pleasant Gap operation intending to use it for the production and sale of fluxing stone to the steel industry, but decided to go into the production and sale of lime shortly thereafter. As soon as Standard installed its rotary kilns it considered itself to be in the lime business. In 1952, Standard decided to go out of the fluxstone business entirely (although 41,750 tons of fluxstone was sold by it from Pleasant Gap during 1953).

39. Standard Lime commenced lime production at Pleasant Gap in May, 1952. Standard's major reason for entering the lime business was that its mining costs ex-

ceeded the level at which it could have made a profit by selling stone to the steel companies.

40. During the years 1957-1961, Standard Lime made annual sales of fluxing stone to various steel companies approximating 10,000-15,000 net tons per year at an f.o.b. quarry price of $1.75 per ton. This fluxing stone was sold to certain steel companies as an accommodation at a time when those companies were in short supply of open hearth stone. Such sales were made to these steel companies because they were good customers of Standard Lime.

41. The accommodation nature of these sales had no bearing on the price charged, and Standard Lime priced this fluxstone so that it was delivered at a competitive price.

42. During the years 1956-1961, Standard Lime used the following tonnages of high calcium limestone extracted at Pleasant Gap for the production of lime:

Year	*Net Tons*
1956	355,965
1957	431,011
1958	350,762
1959	507,766
1960	390,657
1961	388,543

43. The typical chemical analysis for the chemical and metallurgical grade limestone consumed by Standard Lime in its lime kilns were as follows:

Calcium carbonate	97.50%
Magnesium carbonate	1.10%
Silica and insolubles	1.01%
Sulfur	.18%
Iron	.30%

44. During the years 1956-1961, two of Standard Lime's major competitors for all its lime sales were Warner Company and National Gypsum.

45. During these years, Standard Lime neither sold stone to nor purchased stone from other users in the Bellefonte area for chemical or metallurgical purposes.

46. Standard Lime would not have been willing to enter into a long-term purchase agreement for high calcium limestone for a portion of its needs from local suppliers even if such stone were available because it was more desirable to develop their own mine. This could be done only by extracting maximum usable quantities of limestone therefrom. If Standard Lime had purchased part of its limestone requirement elsewhere, the unit cost per ton of the limestone mined by it would have increased, because many of its costs were fixed or not directly variable.

47. In addition to Standard Lime and National Gypsum, Warner Company, during the years 1956-1961, sold lime in substantial competition with Mississippi Lime Company, Mosier, Missouri, Mercer Lime Company, Branchton, Pennsylvania (solely in respect of the Pittsburgh market), and to the East, H. E. Millard Lime and Stone Company at Annville, Pennsylvania.

48. The Whiterock Quarries operated a limestone quarry in Pleasant Gap, Pennsylvania, during the years 1951 through 1961. In 1956, the Company was acquired by Martin-Marietta Corporation and continued to operate as a more or less independent company through 1961. The Company's quarry was located on the same limestone vein as the plaintiff's, that being the Valentine vein.

During the years in suit, Whiterock sold open hearth stone as well as other limestone products. The tons of open hearth stone sold in each of the years, and the price received, were as follows:

Year	*Net Tons Sold*	*f.o.b. quarry price (net)*
1956	27,911[1]	$1.61
1957	29,369	1.73
1958	14,627	1.74
1959	18,915	1.74
1960	29,801	1.74
1961	46,307	1.74

49. The typical chemical analysis for Whiterock's open hearth limestone was as follows:

Calcium carbonate	96.80%
Magnesium carbonate	1.63%
Silica	.80%
Iron	.50%

50. During the years 1956-1961, Whiterock was primarily engaged in the marketing of commercial limestone.

51. No open hearth, blast furnace or kiln feed stone was sold by Whiterock to users in the Bellefonte area during the years 1956-1961.

52. The Valley View Quarries began quarrying in the Bellefonte area during the 1930's. During the years in suit, the Company's quarry operation was conducted along an area directly adjoining Warner's mine. In fact, the Company leased this property from Warner, and purchased the mineral rights to a portion of it from Warner in 1953 or 1954.

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1. This is for eleven months of the year. During the twelfth month, the company sold 21,548 net tons of open hearth and blast furnace stone. The company's records did not permit a breakdown between the two products.

During the years 1956 through 1961, Valley View sold the following net tonnages of open hearth stone for the prices indicated:

Year	*Net Tons Sold*	*f.o.b. quarry price (net ton)*
1956	87,000	$1.55-$1.60
1957	82,600	1.55- 1.60
1958	50,900	1.55- 1.60
1959	52,499	1.55- 1.60
1960	56,533	1.55- 1.60
1961	16,057	1.55- 1.60

The open hearth stone sold by Valley View was 4" x 8" in size. The Company's principal customers for the open hearth stone were the Bethlehem Steel Plant in Johnstown, Pennsylvania, and a brokerage company in Pittsburgh, which in turn sold to various steel companies operating open hearths in Pittsburgh.

53. It would not have been feasible for Valley View to quarry more high calcium limestone than it did during the 195€ 1961 period.

54. Valley View Quarries did not sell any high calcium limestone to the three Bellefonte lime producers during the 1956-1961 period.

55. During the years 1956-1961, Whiterock Quarries and Valley View produced 169,519 and 345,589 tons of high quality, high calcium, limestone respectively, or a total of 515,108 tons. The production varied from an aggregate high of 117,500 tons in 1956 to a low of 62,364 tons in 1961. In four of the six years, the tonnage was below 90,000 tons. During the same period, Warner produced 2,600,682 tons of kilnstone. National Gypsum produced 2,588,289 tons of

kilnstone, Standard Lime produced 2,424,614 tons of kilnstone, for a total of 7,019,485 tons of kilnstone.

56. During the period 1956 to 1961, Whiterock Quarries and Valley View Lime Company could not have satisfied any significant portion of the limestone requirements of Warner Company, National Gypsum or Standard Lime and Cement Company on a combined basis. During such period total production of Whiterock and Valley View approximated 5.6 per cent to 9.5 per cent of the total production of kilnstone produced by Warner Company, National Gypsum and Standard Lime and Cement. Over the six-year period, the total amount of tons of high quality, high calcium stone produced by Whiterock and Valley View was 7.3 per cent of the total net tonnage of kilnstone produced by Warner, National Gypsum and Standard Lime.

57. Comparing the total of Whiterock and Valley View products to Warner alone, the highest percentage was in 1957 when the total Whiterock and Valley View tonnage was 31.5 per cent of Warner's production and the lowest was in 1959 when the total was 19.1 per cent. Taken over the entire six-year period, the total production of Whiterock and Valley View was 25.7 per cent of the kilnstone produced by Warner Company.

58. By the end of 1961, the three Bellefonte lime companies were on the threshold of expansion whereas Valley View only had 90,000 tons left which were exploited over the next three years and in 1962, Whiterock became a captive company (known as the Appalachian Stone Division) of Martin-Marietta and supplied no significant high calcium stone to the open market.

59. High calcium limestone contains a minimum of 95 per cent total carbonate content. High quality, high calcium limestone contains from 97 per cent—98.5 per cent total carbonate content with a minimum of impurities.

60. The principal areas of high calcium limestone consumption in Pennsylvania, Virginia and West Virginia during the years involved were Pittsburgh, Pennsylvania, Bellefonte, Pennsylvania and Bethlehem, Pennsylvania.

61. Various companies producing high calcium limestone in the Virginia Valley area sold principally to steel companies in the greater Pittsburgh district. High calcium limestone producers located at or near Annville, Pennsylvania, sold their limestone eastward to steel companies located in Eastern Pennsylvania, principally Bethlehem.

62. During the years at issue, the significant producers of high calcium limestone in the separate limestone fields of Bellefonte, Annville, York-Thomasville, Vanport, Mosheim, Rogers City-Dundee (excluding captive companies unless they sold to outside users) were: Warner Company, National Gypsum and Standard Lime and Cement Company at Bellefonte; H. E. Millard Lime and Stone Company and Calcite Quarry at Annville; Thomasville Stone and Lime Company at Thomasville; Carbon Limestone Company and Bessemer Lime and Cement Company at Vanport; J. E. Baker, M. J. Grove Lime Company, W. S. Frey and Chemstone at Mosheim (Virginia and West Virginia); and the captive companies of Michigan Limestone and Chemical Company and Presque Isle Stone Corporation at Rogers City-Dundee.

63. Of the companies named in paragraph 62 above, all but those producing stone in the Thomasville-York and Vanport fields (i.e., Thomasville Stone and Lime Company, Carbon Limestone Company and Bessemer Lime and Cement Company) would be considered as producing high quality, high calcium limestone.

64. The J. E. Baker Company operated a quarry a few miles south of Martinsburg, West Virginia. During the

years 1956 through 1961, the Company sold the following tonnages of open hearth, blast furnace and foundry stone for the prices indicated:

Year	*Net Tons Sold*	*Average f.o.b. quarry price (net ton)*
1956	180,518	$1.68
1957	166,469	1.71
1958	152,420	1.74
1959	143,684	1.73
1960	110,053	1.74
1961	56,070	1.62

The vast majority of these tonnages were sold to steel mills in the Pittsburgh area, Youngstown and Weirton, West Virginia areas.

The open hearth stone was sized 10" × 4", blast furnace stone was 4" × 1½", and foundry stone 1½" × ¾".

65. The W. S. Frey Company, Inc., operated a limestone quarry at Martinsburg, West Virginia, during the period January 1, 1956, to March of 1961. For the balance of 1961, the Company moved its operation to Clearbrook, West Virginia after selling its Martinsburg plant.

During each of the years 1956 through 1959, W. S. Frey Company sold approximately 150,000 net tons of open hearth limestone. Prices for these sales averaged $1.75 per net ton f.o.b. quarry. The majority of these sales were made to customers in the greater Pittsburgh area. During the years 1956-1959, the Company sold approximately 75,000 net tons of blast furnace stone annually. Prices for this product averaged $1.65 per net ton f.o.b. quarry. The majority of these sales were also made to customers in the greater Pittsburgh area.

During the year 1960, the Company sold 156,781 net tons of open hearth stone and 80,705 net tons of blast

furnace stone. Prices for the open hearth stone varied from $1.65 to $1.74 per net ton f.o.b. quarry, and the price for blast furnace stone was $1.65 per net ton f.o.b. quarry.

During the year 1961, the Company sold some 275,000 net tons of open hearth stone and 84,000 net tons of blast furnace stone. The average f.o.b. quarry price per (net) ton for the open hearth stone ranged from $1.47 to $1.74.

During 1961, the Company sold 9,493 net tons of kilnfeed to the Mercer Lime and Stone Company. The price per net ton was $1.65. This price was set by the Company to sell at the same price as the blast furnace stone price, which was ten cents per ton less than open hearth stone due to its smaller size. The kilnfeed sold to Mercer was 3″ × 5″ in size. Had Frey instead wanted to sell Mercer a kilnfeed sized ½″ × 2″ (which is in the middle of Warner's kilnfeed size spectrum), Frey's president stated that he would have set the price some five to ten cents less than the price of blast furnace stone and kilnfeed, which was $1.65.

The Company sold its open hearth and blast furnace stone to a variety of steel companies located in Pennsylvania, Maryland, Ohio and West Virginia. During the years in suit, the Company considered itself to be in competition for open hearth stone sales in the greater Pittsburgh area with the Valley View Quarries, Bellefonte, Pennsylvania, Thomasville Stone and Lime Company, and several other Virginia and West Virginia limestone operators.

66. The Chemstone Corporation operated a limestone quarry and lime plant in Strasburg, Virginia, during the years 1956-1961.

During the years 1956 through 1961, the Company sold the following quantities of open hearth and blast furnace stone:

Year	*Net Tons Sold*
1956	230,182
1957	184,666
1958	172,247
1959	185,117
1960	213,251
1961	200,695

The average price per (net) ton received by the Company for open hearth stone ranged from $1.54 to $1.74. The average blast furnace price varied from $1.34 to $1.85. The Company sold its open hearth and blast furnace stone to a large number of customers located in Pennsylvania, Maryland, Ohio, West Virginia, and Michigan.

From the same location, the Company extracted and processed kilnfeed which it burnt to produce lime. About 200,000 net tons of kilnfeed were consumed by the Company annually. The Company was principally in the fluxing lime business, Pittsburgh being its principal market.

67. The M. J. Grove Lime Company conducted two limestone operations in Virginia during the years 1956 through 1961—one at Middletown and the other at Stephens City. The former was an open quarry while the latter was an underground mine.

During the years 1956-1961, the Company sold open hearth stone, blast furnace stone, chemical stone, and kilnfeed.

The Company's total sales of chemical and metallurgical grade limestone from its Middletown and Stephens City plants during the years 1956 through 1961 were as follows:

Year	*Total Net Tons Sold*
1956	197,061
1957	230,138
1958	139,915
1959	124,635
1960	160,906
1961	205,965

During these years, the following average f.o.b. quarry prices were received by the Company:

Year	*Product*	*f.o.b. quarry price (net ton)*
1956	open hearth stone	$1.64-$1.65
	blast furnace stone	1.46- 1.47
1957	open hearth stone	$1.73-$1.74
	bast furnace stone	1.53- 1.54
	kilnfeed	1.57-
1958	open hearth stone	$1.73-$1.74
	blast furnace stone	1.48- 1.54
	chemical stone	1.80
1959	open hearth stone	$1.73-$1.74
	blast furnace stone	1.54
	chemical stone	1.80
	kilnfeed	1.57
1960	open hearth stone	$1.65-$1.72
	blast furnace stone	1.63- 1.65
	chemical stone	1.80
1961	open hearth stone	$1.70
	blast furnace stone	1.61-$1.65
	kilnfeed	1.61

The kilnfeed sales, described above, were all made to the Mercer Lime and Stone Company. The Company sold the following tonnages of kilnfeed to Mercer:

Year	*Net tons kilnfeed sold to Mercer*
1957	2,281
1959	2,818
1960	360
1961	32,122

The Company's open hearth and blast furnace stone customers were located in the greater Pittsburgh area, and the areas of Wheeling, West Virginia; Bethlehem, Pennsylvania; and Maryland.

During all of the years in issue, the Company made lime from kilnfeed mined and processed by it at the Stephens City plant. Approximately 50,000 net tons of kilnfeed were consumed annually in the Company's lime kiln. The lime produced was suitable for all industrial and chemical uses of lime, as was Warner's. The Company faced competition with the Warner Company in lime sale in the Philadelphia, Baltimore, Pittsburgh, and Washington, D. C. areas.

The open hearth and blast furnace stone, chemical stone, and the kilnfeed (both that which was sold and the kilnfeed burnt by the company), were all extracted and processed together, their separation coming only in the screening operation where the stone was sized.

68. During all of the years in suit the Mercer Lime and Stone Company (located in Branchton, Pennsylvania, some 50 miles north of Pittsburgh), operated four vertical lime kilns, which used a size 3″ x 5″ kilnfeed. Vertical lime kilns use a larger size kilnfeed than rotary kilns, e.g.,

5" x 3", compared to 2½" x ¼". Beginning in 1956, and continuing through 1961, Mercer purchased substantial quantities of kilnfeed from the Michigan Limestone Division of U. S. Steel (Rogers City, Michigan plant). During the period in suit the tonnages purchased, and the f.o.b., hold of vessel, Port of Calcite, Rogers City prices,[2] were as follows:

Year	*Net Tons Purchased*	*Average price per ton f.o.b., hold of vessel, Port of Calcite, Rogers City, Michigan*
1956	111,402	$.85
1957	113,663	.92
1958	125,787	.94
1959	119,711	.94
1960	154,102	.94
1961	122,236	.94

The chemical quality of this stone was practically identical to Warner's kilnfeed.

Mercer also purchased quantities of kilnfeed from the M. J. Grove Company in 1957, 1959, 1960, and 1961, and purchased kilnfeed from W. S. Frey and Company in 1961.

69. The high calcium limestone reserves in Pennsylvania, West Virginia, Virginia, Ohio and Michigan are finite deposits with definite limits, contained in separate fields.[3]

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2. This price was the best available from the company. Presumably, the f.o.b. quarry price would be even less, since transportation costs to the ship, and boat loading charges would be eliminated.

3. The Defendant has stated that it knows of no legal distinction between the use of the words "market" and "field" as used in Treas. Regs. 1.613-3(c)(1),(3),(4).

70. During the period 1930 through the years at issue, there were four separate and distinct high calcium limestone producing fields in Pennsylvania. They were:

(a) the Bellefonte field located at Bellefonte, Pennsylvania, in Central Pennsylvania;

(b) the Annville field located near Hershey, Pennsylvania, in Southeastern Pennsylvania;

(c) the York-Thomasville field located near York, Pennsylvania, in Southeastern Pennsylvania; and

(d) the Vanport field located in the vicinity of the Pittsburgh, Pennsylvania, and Youngstown, Ohio, steel centers in Middle-Western Pennsylvania and Eastern Ohio.

71. Thomasville Stone and Lime Company owned and operated a limestone mine and quarry located in Thomasville, Pennsylvania. During the years 1956-1961 Thomasville sold open hearth stone, blast furnace stone, foundry stone and paper mill stone. The largest portion of its open hearth stone was sold to steel companies in the Pittsburgh area and it sold at least the following quantities into the Pittsburgh area:

Year	*Net Tons*
1956	163,895
1957	155,481
1958	114,520
1959	135,479
1960	124,030
1961	141,773
TOTAL	835,178

During these same years, the total open hearth stone production of Thomasville was 1,037,995 tons. The record does not disclose where the difference between the enumerated tonnages of 835,178 and the total tonnages of 1,037,995 tons was sold. Thomasville also sold blast furnace stone to users in the Pittsburgh area as follows:

Year	*Net Tons*
1956	147,749
1957	135,046
1958	97,850
1959	164,227
1960	99,187
1961	71,217
TOTAL	715,276

Accordingly, during the years 1956-1961, a total of at least 1,550,454 tons of open hearth and blast furnace stone was sold by Thomasville to Pittsburgh area users.

72. The chemical analysis of Thomasville's open hearth and blast furnace stone was as follows:

Calcium carbonate	91.00%
Magnesium carbonate	7.50%
Silica	1.00%
Aluminum	.30%
Iron	.20%

Thomasville's limestone was not suitable for production into high quality, high calcium lime which could have served the same broad spectrum of uses as Warner Company's lime and Thomasville itself believed that its stone was of lower quality for purposes of making lime and this quality

made it unable to compete for sale of its stone to a high calcium lime producer.

73. The primary target market for limestone produced in Virginia and West Virginia during the period 1956 to 1961 was the Pittsburgh steel district. The target market for limestone sold from Virginia and West Virginia to Mercer Lime and Stone Company to be used as kiln feed for calcination into lime was Branchton, Pennsylvania, the site of Mercer's plant.

74. The target market for limestone sold from the Rogers City-Dundee field area to Mercer Lime Company was Branchtown, Pennsylvania.

75. The target market for limestone produced by an integrated lime or cement miner-manufacturer, assuming it was disintegrated, would be the site of its manufacturing facilities, the locale in which the stone is used and consumed.

76. The target market for limestone produced at Bellefonte, Pennsylvania, by Warner Company to be calcined into lime was Bellefonte, Pennsylvania, the site of its manufacturing facilities.

77. The target market for limestone produced by National Gypsum and Standard Lime and Cement Company, respectively at Bellefonte and Pleasant Gap, Pennsylvania, to be calcined into lime at such locations, is Bellefonte and Pleasant Gap, respectively.

78. The Bellefonte field, during the years involved, was the major open market lime producing area for high quality, high calcium lime in Pennsylvania and the second largest area [4] of high calcium lime production in the United States.

4. The largest area of high calcium lime production is in Missouri.

During the period 1956 through 1961, approximately 67 to 68 per cent of the high calcium lime produced in the State of Pennsylvania was produced in the Bellefonte field. Warner Company, National Gypsum and Standard Lime and Cement Company extracted between 1,000,000 to 1,300,000 net tons of limestone annually during the years at issue, for use as kilnstone in the manufacture of lime and lime products. Their collective annual production of high calcium lime, which ranged from approximately 500,000 to 727,000 net tons during the period involved, far exceeded the total production of all other areas in Pennsylvania, Virginia, West Virginia, Ohio, Michigan, Maine, Vermont, New Hampshire, Massachusetts, Connecticut, New York, Maryland, Delaware and New Jersey.

79. During the years 1956 through 1961, Warner Company sold and shipped lime to various purchasers in the States of Pennsylvania, New York and West Virginia. The Bellefonte area was considered by the Company to be a good location for the production of lime not only because the limestone there was of very high quality and there were proven reserves sufficient to support a lime plant, but also because the location was geographically good with relation to the lime market.

80. During the period 1956-1961, if the Warner Company's operations had been separately owned mining and manufacturing companies respectively, the "Warner Mining Company" would have sold its limestone to the "Warner Manufacturing Company" at a price of about $2.00 per net ton.

81. Because the direct and indirect mining costs for Warner Mining Company were over $2.00 per ton, Warner Mining Company would not attempt to sell its stone to the Pittsburgh and Eastern Pennsylvania (Bethlehem) market

areas assuming it could only obtain a maximum price, f.o.b. Bellefonte, of $1.76 or less per ton, nor would it attempt to sell stone to Warner Manufacturing Company at such price.

82. During the years 1956-1961, Warner operated its Bellefonte mine as a source of kilnstone, which kilnstone was used in its kilns for the production of lime.

83. Generally, there are three (3) kinds of costs: variable costs, which vary with the volume of production; semivariable costs, which have variable elements of fixed costs; and fixed costs, which do not vary or which vary only within very wide ranges of production increase or decrease, and would not vary if production would decrease by 75,000 tons. The reason for the increase in the cost per ton of producing kilnstone in 1956 and 1961, if 75,000 tons were purchased and production was reduced by that amount, is that the fixed cost would have remained relatively constant and increased on a per ton basis inasmuch as the number of tons produced was decreased with the overall effect of increasing the cost of the remaining tonnage. If production of kilnstone had been decreased by 75,000 tons in each of the years 1957 through 1960, the result would have been similar in that the cost of producing the remaining tonnage of kilnstone would have increased.

84. In 1956, Warner Company produced 445,031 tons of kilnstone and in 1961, the Company produced 286,794 tons of kilnstone. If Warner Company had purchased 75,000 tons of kilnstone elsewhere during the years 1956 and 1961 and reduced its production by that amount, the cost per ton of producing the remaining kilnstone for 1956 would have increased by $.26 per ton and the cost per ton of producing kilnstone in 1961 would have increased by $.51 per ton.

DISCUSSION.

Section 611(a) [5] provides that in computing net income, there shall be allowed as a deduction in the case of a mine, a reasonable allowance for depletion. The applicable Regulation [6] provides that for exhaustible natural resources (other than standing timber), the depletion allowance shall be computed by either the cost depletion or percentage depletion methods, whichever results in the greater depletion allowance. Here, plaintiff and defendant both agree that Warner Company is to compute its depletion allowance by using the percentage depletion method provided for in Section 613. The allowance provided for in Section 613 is 15 per cent of the gross income from the property, not to exceed 50 per cent of the taxpayer's taxable income from the property. Section 613(c)(1) defines "gross income from the property" as "gross income from mining."

Warner Company is an integrated miner-manufacturer located at Bellefonte, Pennsylvania, which burns all of its limestone as kilnfeed in its kilns for the purpose of producing lime and sells virtually no limestone to other manufacturers or users at any location. Section 613 only permits a depletion allowance in connection with taxpayer's mining operation, and both parties have agreed that taxpayer's mining operation ceased with the completion of the secondary crushing process. See Rev. Rul. 62-5, 1962-1 Crim. Bull. 88.

The Regulations go on to provide that where the ". . . taxpayer processes the mineral before sale by the application of non-mining processes . . ., gross income from mining shall be computed by use of the representative market or field price of [a] . . . mineral of like kind and grade as the

5. All references are to Sections of the Internal Revenue Code of 1954 (Title 26, U. S. C.) unless otherwise indicated.

6. Treas. Regs. on Income Tax (1954 Code), § 1.611-1(a)(1).

taxpayer's . . . mineral after the application of the mining processes actually applied." Treas. Reg. 1.613-4(c)(1). "If it is impossible to determine a representative market or field price . . ., then gross income from mining shall be computed by use of the proportionate profits method . . . ." Treas. Reg. 1.613-4(d)(1)(i). Both parties agree that the questions to be answered by this Court are as follows:

> 1. Is there a representative field or market price per ton to be utilized by plaintiff in computing gross income from mining kilnstone calcined into lime at Bellefonte in each of the years 1956 through 1961 inclusive; and
>
> 2. If so, what is the amount of such price per ton of kilnstone by which each ton of kilnstone should be multiplied to arrive at gross income from mining kilnstone?

Warner Company alleges that no representative market or field price for its kilnstone existed at Bellefonte during the years in question and therefore, its percentage depletion allowance must be computed by the proportionate profits method. See Treas. Reg. 1.613-4(d)(1) and (4). The government, on the other hand, contends that a representative market or field price did exist for Warner's kilnstone at Bellefonte and "all over" and that this price was about $1.70 per net ton.

To determine whether or not a representative market or field price for Warner's kilnstone existed during the years in suit, it is first necessary to circumscribe the market or field in which the price per net ton, if any, is to be computed as it relates to the facts developed in this case.[7]

7. The regulations do not define "representative market or field price."

Warner Company produced and consumed its high calcium limestone at Bellefonte, Pennsylvania during the 1956-1961 period. The "Bellefonte Ledge" was and is a distinct limestone deposit having finite dimensions in Centre County, Pennsylvania. In addition to the Bellefonte area, there existed three other areas in Pennsylvania which were considered to be high calcium limestone producing areas. These included the Vanport area in Middle Western Pennsylvania, the Annville area in Southeastern Pennsylvania, and the York-Thomasville area in Southeastern Pennsylvania. Each of these areas was a separate, finite deposit of limestone.

Neither the government nor Warner Company attempt to draw any distinction between the words "market" and "field" as used in the Regulation. See Treas. Reg. 1.613-4(c)(1). Warner contends that the relevant market or field must be limited to Bellefonte because it is a distinct field, it is where Warner consumed its limestone and it is the only area in which Warner could have competed and did compete because of Warner's cost of mining its limestone. The government contends that a market for Plaintiff's kilnstone existed in Pittsburgh and in Eastern Pennsylvania to which it could have sold its kilnstone and that the prices paid in these markets by fluxstone consumers establishes a representative market or field price at Bellefonte and all over the Pennsylvania, Virginia, and West Virginia area.

This Court is of the opinion that the market or field price must exist at Bellefonte if it exists at all and that prices from other markets are not relevant to establish the existence of a price at Bellefonte.

Bellefonte is a distinct limestone field, area and market which exists as a lime producing center and not as a limestone-fluxstone producing center. As the facts indicate, great quantities of kilnstone are consumed annually in the

Warner, Standard Lime and National Gypsum kilns. Indeed, the only reason for Warner Company's existence at Bellefonte at all was for the production of lime, and neither Warner, nor Standard Lime, nor National Gypsum could have sold fluxstone competitively into the Pittsburgh area without losing money on the sales because of their high costs of mining.

The government contends that a representative market or field price existed "all over" the Pennsylvania, Virginia and West Virginia area, and that by computing the weighted average price from prices of producers selling fluxstone in these areas, we will come up with the representative market or field price of Warner's kilnstone, f.o.b. quarry at Bellefonte. However, if we were to sustain this arithmetic, we would be going against the great weight of the case law which describes the objective of computing gross income from mining by the representative market or field price method to be the ascertainment of the price at which the integrated miner-manufacturer would have sold to itself had the miner-manufacturer been disintegrated into separate mining and manufacturing entities. See *United States v. Cannelton Sewer Pipe Co.*, 364 U. S. 76 (1960); *United States v. Henderson Clay Products*, 324 F. 2d 7 (5th Cir., 1963). To establish a representative market or field price for Warner's limestone, we must limit the market to one in which the taxpayer would have and could have competed in order to obtain a price which is in fact representative. This necessarily involves a factual economic analysis. It is true that the cost factors of the integrated miner-manufacturer are not to be considered in determining the price at which it would sell to itself, but cost factors do define the market or markets into which plaintiff would have sold its limestone had it chosen to do so. The "market" or "field" concept is an economic concept which necessarily assumes the presence of actual competition.

The government's theory would require us to cut competition out of the market or field price concept and leave us in the never-never land of tax theory. This we are unwilling to do. If Warner Company had sold its limestone to Pittsburgh at $1.70 per ton, it would have eventually gone out of business because Warner's cost of mining its limestone averaged $2.00 per ton. The government contends that there was a market for Warner's limestone at Pittsburgh because Warner could have sold its limestone there at $1.70 per ton. Warner could have sold its limestone anywhere if the price were competitive. The simple answer is that there was a market for limestone at Pittsburgh, at Bethlehem, at Chicago, at Detroit, and "all over" the United States, but not for Warner's limestone. Bellefonte was the only relevant market for Warner's stone during the period in question based on Warner's unique situation at Bellefonte.

Other cases which have dealt with the issue presented here tend to support the Court's conclusion despite the particular fact questions involved in each case. With respect to clay, gas and coal, market or field prices are established from sales, if any, which were consummated within the geological area surrounding taxpayer and from producers which were considered to be in competition with taxpayer. See generally, *Henderson Clay Products v. United States*, 377 F. 2d 349 (5th Cir., 1967); *Shamrock Oil and Gas Corp. v. Commissioner*, 35 T. C. 976, 346 F. 2d 377 (5th Cir., 1963); *Alabama By-Products Corp. v. Patterson*, 258 F. 2d 892 (5th Cir., 1958). See also, *United States Pipe and Foundry Co. v. Patterson*, 203 F. Supp. 335, 356, 363-64 (N. D. Ala., 1962).

One further observation is necessary at this point. Recently adopted Treasury Regulation 1.613-4(d)(6) states:

> "(6) *Method using prices outside the taxpayers market.* Under the 'other market method' the tax-

payer uses representative market or field prices established outside his [sic] markets, provided that conditions there are substantially the same as in his [sic] markets. For example, it may be appropriate in a particular case to establish the representative market or field price for pellets containing 60 percent iron which are *produced and used* in market area X by reference to the representative market or field price for pellets containing 60 percent iron which are *produced and sold in adjacent market area* Y, provided that conditions in the two marketing areas are shown to be substantially the same." (emphasis supplied)

We agree with Plaintiff, Warner Company, that the government's argument attempts to establish a representative market or field price for Warner's limestone at Bellefonte by using the "other market" method described by the above Regulation. However, this method is a tertiary method to be used only if no representative market or field price is found to exist and the proportionate profits method does not accurately reflect taxpayer's gross income from mining. Although this regulation does not apply to the years in question, it is persuasive support for Warner's contention that the market or field be limited to Bellefonte.

Only the case of *Ames v. United States*, 330 F. 2d 770 (9th Cir., 1964, *aff'g Ames v. U. S.*, 63-1 USTC ¶ 9121, appears to be at odds with Warner's contention. In that case the Court of Appeals for the 9th Circuit upheld the finding of the United States District Court of Arizona that a representative field or market price did exist in the state of Arizona based on actual sales made by another quarrier located 150 miles north of taxpayer's lime plant. However in *Ames*, there is no discussion of how the "market or field" prices were determined or why the "market or field" was

defined by state boundaries. It is unlikely but possible that the taxpayer's mine was located on the same deposit as the mine 150 miles north of it. The District Court in *Ames* rejected sales by California and Michigan producers because they were too "remote." We do not have the benefit of the learned Court's reasoning in *Ames* as to why the particular sales used were used to establish a representative market or field price and therefore will not consider it as dispositive of the question before us.

We must now turn our attention to the activities at Bellefonte, Pennsylvania and first determine whether or not a representative market or field price existed there.

As the findings of facts indicate, five limestone producers mined limestone at Bellefonte. The facts also show that of the five, only Valley View and Whiterock Quarries sold limestone to the Pittsburgh steel producers for consumption as fluxstone on a regular basis. Warner Company, Standard Lime and Cement, and National Gypsum were not in the business of selling limestone to anyone during the 1956-61 period and except for several insignificant sales by Standard Lime and Cement and Warner Company, they sold no limestone to anyone outside the Bellefonte area.

In addition, none of the five mining companies located at Bellefonte sold any limestone to any lime producer located at Bellefonte during the years in question.

Warner Company made sales of cupola stone outside Bellefonte during the period for prices of $2.00 and $2.01 per ton. The tonnages involved were minute, less than .0205 per cent of the total crushed limestone used by Warner in its kilns, and were accommodations to several of Warner's customers. Because of the insignificant amounts involved as well as the accommodation nature of the sales, these sales cannot be used to establish a representative market or field price for Warner's limestone. In-

deed they are specifically excluded by the applicable regulation. See Treas. Reg. 1.613-4(c)(3).

Also, Standard Lime and Cement Company made annual sales of fluxing stone to certain steel companies amounting to 10,000-15,000 net tons per year at an f.o.b. quarry price of $1.75 per ton. The evidence tended to show that these sales were made as accommodations to certain of Standard's customers, and the small amounts of fluxstone involved coupled with the fact that Standard was not in the business of selling fluxstone to Pittsburgh consumers and had in fact gone out of the fluxstone business in 1952 tend to support that conclusion.

Sales of fluxstone to the Pittsburgh market were made by Whiterock Quarries and Valley View on a regular basis. These quarries were in the business of selling fluxstone to Pittsburgh, and the sales were actual, competitive sales from the Bellefonte area.

These sales may be used to establish a representative market or field price at Bellefonte if they are deemed to be substantial sales or as set forth in the Regulation, they are not "insignificant." During the 1956-1961 year period, Warner, Standard Lime and National Gypsum collectively produced between 1 and 1.3 million tons of limestone annually, most of which was consumed in their kilns at Bellefronte. The annual production of Whiterock and Valley View averaged approximately 5.6 per cent to 9.5 per cent of the total limestone tonnage produced by Warner, Standard Lime and National Gypsum at Bellefonte during the period. We are of the opinion that the Whiterock and Valley View sales must be compared to the total Bellefonte production of the three lime producers located there because the price established by these sales, if any, would necessarily be the representative market or field price for all three companies. Warner, Standard Lime and National

Gypsum have virtually identical positions in terms of mining costs, competition and available markets.

In a given case, "insignificant" sales may only involve a bare volume consideration. If we treat the volume question as one requiring substantial sales, then we would compare the Whiterock and Valley View tonnages of limestone of like kind and grade which were sold during the period with the tonnages produced by Warner, Standard Lime and National Gypsum. The word "substantial" has been defined as meaning considerable in amount. See *Levenson v. United States,* 157 F. Supp. 244, 250 f.n. 19 (N. D. Ala., 1957). The Court is of the opinion that these sales were not considerable in amount because volume-wise the amount of stone sold was only an average of 7.3 per cent of the total tonnage of the three lime producers located at Bellefonte.

But even if the above sales are considered significant with respect to quantity, the sales would still be insignificant under the facts of this particular case. Whiterock and Valley View are low volume, low cost operators which do not mine stone by Warner's method. The facts establish that even if Warner Company had purchased every available ton of suitable limestone produced by Whiterock and Valley View during the period, Warner would have continued to mine limestone at Bellefonte with no reduction in cost per ton. In fact, as findings 196 and 197 indicate, cost per ton would have increased. This circumstance renders the production of Whiterock and Valley View insignificant in relation to Warner's operation, and exceptional if not unusual in the Bellefonte market area, within the meaning of Treas. Reg. 1.613-4(c)(3). Therefore, they are not to be considered on the issue of the existence or the specific amount of a "representative" field or market price.

But even if the Whiterock and Valley View production were regarded as technically significant, unexceptional, and usual within the letter of Treas. Reg. 1.613-4(c)(3), this would not be mechanically dispositive of the question of whether a "representative" field or market price existed during the years in question. The regulation is merely advisory, and it does not purport to dictate the outcome of factors considered, but merely to define what may not be considered. Here, even if we were to consider the Whiterock-Valley View production, we would not hold that it established a "representative" price. The low volume of the Whiterock-Valley View production was such that they could not have been an economically feasible substitute source of even a significant part of Warner's needs. In other words, what Whiterock and Valley View did in terms of price during the years 1956-1961 was irrelevant, vis a vis Warner's situation, and could not establish a market or field price which is representative of the price at which Warner would have sold its limestone to itself at Bellefonte during this period. This is not a situation where an integrated producer chose to continue with an inefficient mining operation in the face of a more economic source of supply.

There was no more economic source of supply. Warner, because of its capital investment over many years, could not move to a cheaper source, and because of its volume needs, its mining operation was the cheapest means of obtaining the raw materials it needed to stay in business. All these factors combine to dictate the conclusion that there was no representative field or market price for its mined product, and that it was therefore entitled to use the proportionate profits method in figuring depletion. Indeed, the Warner Company situation appears to be the classic case for which the proportionate profits method was provided.

Purchases In Later Years
By Warner Company

At trial, the government was permitted to put into evidence certain purchases of limestone from the Appalachian Stone Division of the Martin Marietta Corporation for the period starting June 1, 1966 and ending April 30, 1971. These purchases by Warner were placed in evidence on the condition that they might later be determined not to be relevant. The Court has considered the relevancy of these purchases and concludes that they do not tend to prove the existence *vel non* of a representative market or field price for Warner's limestone at Bellefonte during the 1956-1961 period. The purpose for which these purchases were offered was that they allegedly demonstrate that Warner Company could have purchased limestone from outside sources during the years in question even though Warner did not and said it could not do so. A representative market or field price may exist in one year but not in another. Purchases made by Warner in subsequent years are relevant for those years only; they do not shed any light on the feasibility of purchasing limestone from other sources in prior years unless there is proof that conditions during those subsequent years were virtually the same as conditions during the years in suit. The government has presented no evidence as to why the price of Whiterock's open hearth stone averaged $1.71 per net ton during 1956-1961 period, but in 1966-1969 sold stone to Warner Company for $1.20 per net ton f.o.b. quarry, and from 1969-1971 sold stone to Warner for $1.45 per net ton f.o.b. quarry. Conditions must have changed substantially to permit a $.50 per ton reduction in price between 1961 and 1966. This drop in price permitted Warner to buy stone and ship it for $.30-$.35 a ton to its Bellefonte kilns at a total cost which was less than their own $2.00 per net ton cost during the

period. To say that Warner could have done this in 1961 when the price was $1.74 per ton, when it in fact did not do so, involves too much speculation to establish the existence of a representative market or field price.

There is no need to consider the issue of freight adjustments or the possibility of discrimination alluded to at the trial and in the briefs because of the Court's determination that no representative market or field price existed at Bellefonte during the 1956-1961 period.

CONCLUSIONS OF LAW.

1. The claims for refund on which Plaintiff relies were timely as to all tax and interest claimed thereon with respect to each taxable year here involved.

2. This Court has jurisdiction over the subject matter and the parties involved in this action.

3. Section 611 of the Internal Revenue Code allows a taxpayer to deduct certain sums as depletion deductions from gross income to determine net income.

4. Section 613 of the Internal Revenue Code and the regulations promulgated thereunder, allowed a taxpayer during the years at issue a depletion deduction, in the case of limestone, of 15 per cent of the "gross income from the property" (subject to the limitation that the deduction cannot exceed 50 per cent of the taxpayer's "net income" from the property computed without allowance for depletion). "Gross income from the property" is defined as "gross income from mining."

5. Pursuant to regulations duly promulgated by the Commissioner of Internal Revenue, where the minerals mined are not actually sold, "gross income from mining" is to be determined constructively. Reg. 1.613-4 provides that the taxpayer shall first ascertain if there is a represent-

ative field or market price of a mineral product of like kind and grade as the minerals mined, and if so, that price shall be used to determine gross income from mining. Conversely, if a representative field or market price does not exist, then gross income from mining shall be computed by use of the proportionate profits method.

6. There is no legal distinction between the use of the words "market" and "field" in Treasury Regulations § 1.613-3(c)(1)(3) and (4). See Defendant's answer to plaintiff's Interrogatory No. 31(b).

7. The open hearth stone sold by Whiterock and Valley View from Bellefonte was of "like kind and grade" as that produced by Warner Company at Bellefonte because it was sufficiently equivalent in chemical, mineralogical, physical and geological characteristics to be used or was by commercial standards suitable for use, for essentially the same purposes, in substantially identical application, as the uses for which the taxpayer's mineral is put. Reg. 1.613-4(c)(2). *United States v. Henderson Clay Products, supra; Alabama By-Products Corp. v. Patterson,* 358 F. 2d 892, 898 (5th Cir., 1958).

8. Sales prices for limestone produced in the Virginia Valley and Thomasville, Pennsylvania, fields may not be used to determine a representative field or market price for kilnstone produced by Warner Company at Bellefonte because Virginia Valley and Thomasville are separate and distinct fields from Bellefonte.

9. The market area of an integrated miner-manufacturer, such as Warner Company, is the area in which it extracts and converts its mineral into its manufactured product.

10. The Virginia Valley and Thomasville fields serve the target market of Pittsburgh, Pennsylvania, a target

market separate and distinct from the Bellefonte target (consumption) market area and one which was economically unavailable to limestone produced at Bellefonte by Warner Company and the other Bellefonte lime manufacturers.

11. Prices obtained from Virginia Valley and Thomasville sales to Pittsburgh do not establish a representative field or market price for kilnstone mined and calcined into lime at Bellefonte, because they are prices from "other market" areas.

12. The sales of fluxstone from the Bellefonte field during the years in question were not substantial, whether compared to Warner Company's production or to the production of the three Bellefonte lime producers, and do not establish a field or market price which is representative of the price for kilnstone produced in the Bellefonte field. See Reg. 1.613-4(c)(3).

13. The sales of fluxstone from the Bellefonte field during the years in question by the Whiterock and Valley View quarries were insignificant, exceptional and unusual, and therefore cannot be used to establish a representative market or field price for Warner's kilnstone mined at Bellefonte, Pennsylvania.

14. Specific sales by Warner Company and Standard Lime and Cement Company during the period in question, not only were insignificant in volume, but were also accommodation sales and are therefore disqualified from establishing a representative field or market price.

15. The f.o.b. quarry prices for kilnstone purchased in 1966-1971 by Warner Company are not relevant and are therefore not admissible into evidence.

16. There is no representative field or market price for kilnstone produced by Warner Company at Bellefonte,

during the years involved. It follows, therefore, that Plaintiff, Warner Company, must compute its depletion base, "gross income from the property", for its Bellefonte mine, by reference to the proportionate profits method of computation.

Any statements of fact or law found in this Court's discussion above which have not been specifically enumerated in the sections entitled "Findings of Fact" and "Conclusions of Law" respectively, are hereby designated "Supplemental Findings of Fact and Conclusions of Law."

ORDER.

And Now, to wit, this 28th day of March, 1973, it is hereby Ordered that

(1) judgment on the issue of liability be entered in favor of Plaintiff, Warner Company, and against the Defendant, United States of America; and

(2) plaintiff, Warner Company, compute its gross income from mining for its Bellefonte mine by the proportionate profits method set forth in the appropriate Treasury Regulations and as agreed to by the parties hereto, and submit its itemized computation of any refund due for the Court's approval.

It Is so Ordered.

Clarence C. Newcomer,
Clarence C. Newcomer, *J.*

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1974

No. 74-965

WARNER COMPANY, *Appellant*

v.

UNITED STATES OF AMERICA, *Appellee*

AMICUS CURIAE BRIEF OF THE NATIONAL LIME ASSOCIATION IN SUPPORT OF THE PETITION FOR CERTIORARI

JAY W. GLASMANN
1700 Pennsylvania Ave., N.W.
Washington, D. C. 20006
Attorney for Amicus Curiae

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INTEREST OF THE AMICUS CURIAE

The National Lime Association, which has obtained the consent of both the Counsel for the Appellant and the Appellee to file a brief Amicus Curiae in support of the petition for certiorari in this case (*see* Appendix), is a national trade association comprised of approximately 50 companies representing over 85 percent of the United States commercial lime industry

production capacity. A large majority of the companies are integrated miner/manufacturers of lime, which is produced by calcining at high temperatures high quality limestone. Some members also sell crushed and ground limestone to the metallurgical and chemical process industries and for other purposes.

Since most members of the Association are integrated miner/manufacturers in the lime business, they have a direct interest in any determination as to the proper method to be employed by such an entity in determining the allowable percentage depletion on its raw minerals. Moreover, many of the members use the representative field or market price method in determining a constructive gross income from mining for depletion purposes, and would necessarily be directly affected by any decision the Court were to make regarding the proper application of this method.

By this brief, The National Lime Association wishes to aid the Court in understanding the national importance of the issues in this case and the need to clarify for integrated miner/manufacturers in all fields the proper rules to apply in determining the percentage depletion to which they are entitled. The Association also seeks to show this Court that the decision of the Third Circuit Court of Appeals is contrary to the teaching of this Court, and in conflict with numerous other federal circuit court decisions.

STATUTES INVOLVED

This petition for certiorari involves the proper application of Internal Revenue Code sections 611 and 613 (26 U.S.C. § 611 and § 613) and the regulations thereunder.

QUESTION PRESENTED

Whether in determining a representative field or market price for the limestone mined by the petitioner, an integrated miner/manufacturer, in order to determine its gross income from mining for purposes of calculating the percentage depletion to which it is entitled under Internal Revenue Code sections 611 and 613, the Court of Appeals improperly applied Treasury Department regulations in such a manner as to deprive the petitioner of the statutory depletion allowance provided it by Congress.

STATEMENT OF THE CASE

During 1956-1961 (the years in issue), petitioner was in the business of manufacturing and selling lime at Bellefonte, Pennsylvania.[1] Bellefonte is a distinct and separate field of limestone located in Centre County, Pennsylvania. For many years, Pennsylvania has been one of the leading producers of limestone for high calcium uses.

Petitioner mined its own limestone on property adjacent to its manufacturing facilities. Initially, it quarried the limestone; however, around 1921 or 1922 a switch to a comparatively high-cost deep mine shaft (underground method) was required to obtain the necessary high quality of stone required for lime production. This method is also necessarily employed by the petitioner's competitors in the Bellefonte area (National Gypsum Company and Standard Lime and Cement Company). The mined limestone is crushed and then burned, or calcined, producing pebble lime and

[1] Actually, it carried on business at other locations but only the depletion allowable at Bellefonte was in issue.

other lime products which are subsequently refined and sold by the petitioner. Petitioner's integrated Bellefonte lime operations earned a net profit in each of the years in question.

The two largest uses of high quality limestone are the manufacture of lime and fluxstone in producing steel. During the years at issue, a number of steel companies located in the Pittsburgh area purchased large quantities of limestone for the latter purpose. The limestone was extracted primarily in Virginia and West Virginia by the comparatively low-cost open-face quarrying method. The f.o.b. quarry price was $1.76 per net ton or less. Of course, the delivered price was much higher.[2]

In the years in question the three large scale miners in the Bellefonte area, including the petitioner, consumed practically all of their own limestone.[3] However, a relatively minor amount of fluxstone was provided to the steel companies at f.o.b. quarry prices of approximately $1.55-$1.74 per net ton by the two comparatively low-cost open-quarry producers operating in the Bellefonte area (Whiterock Quarries and Valley View Lime Company). The net tons of limestone sold by these quarries averaged 7.3 percent of the net tons of limestone extracted and used by the petitioner, Na-

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[2] The transportation charges from the Virginia Valley to Pittsburgh for the years in issue ranged from approximately $2.04-$2.67 per net ton.

[3] Warner Company sold less than one percent of its output annually. National Gypsum Company sold no fluxing stone or kilnstone during the years in question. Standard Lime and Cement Company did sell approximately 10,000 to 15,000 net tons of fluxstone annually, to steel companies, but these were accommodation sales made because the steel companies purchased other products from Standard.

tional Gypsum and Standard during the years at issue. Not only would the limestone requirements of the petitioner and its two competitors not have been met by the production of these two quarries, but if more limestone could have been mined by these quarries, it could only have been accomplished at a far higher cost per net ton. Additionally, the f.o.b. price of this limestone would have increased significantly in value if the petitioner and its two competitors were to attempt to purchase the stone in arm's-length competition with each other. Furthermore, a higher price than charged to the Pittsburgh market could have been exacted by these quarries due to their proximity to the petitioner and its competitors.

On its tax returns for the years in issue, the petitioner calculated its percentage depletion by the use of the proportionate profits method because of the lack of any representative field or market price in its market upon which it could make a calculation of its constructive income from its mining operations (*see infra,* for a full discussion of these various methods). The Commissioner of the Internal Revenue Service subsequently assessed a deficiency for the years in question based on an application of the representative field or market price method, using a price of $1.70 per net ton f.o.b. quarry. The petitioner paid the deficiency and sued for a refund in the District Court for the Eastern District of Pennsylvania. The District Court found that the petitioner's relevant market was Bellefonte and that since no representative field or market price existed there during the years at issue, the petitioner was entitled to calculate its depletion allowance using the proportionate profits method.

The Court of Appeals for the Third Circuit subsequently reversed the District Court's judgment, holding that the petitioner's relevant market should not be limited to Bellefonte. Without specifying what other markets may be considered relevant, the Court found that sales to the Pittsburgh market from areas outside of Bellefonte (principally from the Virginia Valley) could serve to establish a representative market price. Since these sales were made at $1.76 per net ton f.o.b. quarry, and petitioner's mining costs were in excess of $2.00 per net ton, petitioner therefore would have no gross income from mining and consequently would be entitled to no percentage depletion.

In so finding, the Court held, in what appears to be in conflict with the Supreme Court's decision in *United States* v. *Cannelton Sewer Pipe Co.*, 364 U.S. 76 (1960) (*see infra* for a full discussion of this case), that the price which the manufacturing arm of an integrated miner/manufacturer would pay to its mining half, if disintegrated, was irrelevant in determining a representative field or market price. Furthermore, the Court of Appeals refused to make any adjustment to the f.o.b. quarry price from the Virginia Valley for the freight differential between the Virginia Valley to Bellefonte.

ARGUMENT

I. The Petition for Certiorari Should Be Granted Because the Decision of the Court of Appeals With Respect to the Determination of the Constructive Mining Income of an Integrated Miner/Manufacturer for Purposes of Percentage Depletion Is in Conflict With This Court's Decision in United States v. Cannelton Sewer Pipe Company.

Under Internal Revenue Code sections 611 and 613, a taxpayer is provided with a depletion allowance based on a percentage of its gross income from mining. If

the taxpayer sells the mined product, there is usually little problem in ascertaining "gross income from mining". However, where the taxpayer is an integrated miner/manufacturer, the gross income from mining must be constructively determined.

Treasury Regulations (hereinafter Regulations) Section 1.613-4(c)(1) provides that in determining a taxpayer's gross income from mining, if the taxpayer processes the ore or mineral before sale by the application of non-mining processes, or uses it in his operations, gross income from mining shall be computed by use of the representative market or field price of an ore or mineral of a like kind and grade as the taxpayer's ore or mineral after the application of mining processes actually applied, but prior to the application of non-mining processes. If it is impossible to determine a representative market or field price, the gross income from mining shall be computed by use of the proportionate profits method, unless the taxpayer shows that some other method is more appropriate. Regs. Section 1.613-4(d)(1). Thus, in determining gross income from mining for an integrated miner/manufacturer, the first step is to determine if there is a representative field or market price.

The Regulations are not very helpful in defining what a representative price is. They merely state that the objective in computing gross income from mining by the representative market or field price method is to ascertain, on the basis of an analysis of actual competitive sales by the taxpayer or others, the amount which most nearly represents the approximate price for which the taxpayer, in light of market conditions, could have sold his ores or minerals, if prior to the

application of non-mining processes, the taxpayer had sold the quantities and types of ores and minerals to which he applied non-mining processes. Regs. Section 1.613-4(c)(1). Unfortunately, the Regulations do not elaborate on how to determine in what market and to whom the taxpayer should be considered to have sold his minerals in establishing this hypothetical representative price.

This Court has to some extent clarified the type of sales which will establish a representative field or market price, if any exists. In *United States* v. *Cannelton Sewer Pipe Co., supra,* this Court held that in the case of an integrated miner/manufacturer, depletion must be based only on the miner's constructive income from the raw mineral product. Therefore, the Court continued, *"Congress intended integrated mining-manufacturing operations to be treated as if the operator were selling the mineral mined to himself for fabrication."* 364 U.S. at 89. (Emphasis added.) While the issue in *Cannelton* dealt with the proper cutoff point of the mineral (*i.e.* the point at which the mineral was first commercially marketable and consequently the stage at which the gross income from the mineral, if sold, would represent gross income from mining), the enunciated test applies equally to any determination of a representative field or market price for this first commercially marketable product. That is, the price at which the mining half would sell its minerals to its manufacturing half in an arm's-length transaction, and conversely, the price which the manufacturing half would pay the mining half for its minerals, must necessarily be the representative market price if the integrated miner/manufacturer is to be treated as selling its minerals to itself.

The Circuit Court's decision in this case is the result of its determination that while an integrated miner/manufacturer should be regarded as selling to its manufacturing half, this does not mean that the price which the manufacturing half would pay to the mining half is relevant. Instead, the essential criteria, according to the Third Circuit, should be the price a consumer located elsewhere (Pittsburgh), who was purchasing elsewhere (Virginia Valley) would pay for the raw mineral at Bellefonte; this is not necessarily what the manufacturing half would pay for the comparable mineral. This interpretation of *Cannelton* is wholly unwarranted and in contradiction of the intent of Congress, as expressed in *Cannelton,* to permit integrated miner/manufacturers to take percentage depletion on their constructive gross income from mining operations. Surely treating the mining half as if it were disintegrated and selling to the manufacturing half could not possibly mean that the mining half should be treated as if it were selling to some other consumer. Of course, the price that the manufacturing half would pay the mining half must be based on representative arm's-length sales in the miner/manufacturer's market of like kind and grade minerals, if any such sales have taken place. However, this is not to say that the mandated hypothetical sale must be based on the price *any* consumer would pay for the raw minerals. Under the rationale of *Cannelton,* the mining half should be treated as if it were selling to any other consumer located in the same market as its manufacturing half and with the reasonably identical needs of its manufacturing half, but totally independent of the mining half.

II. The Petition for Certiorari Should Be Granted Because the Decision of the Court of Appeals With Respect to the Determination of the Constructive Mining Income of an Integrated Miner/Manufacturer Is in Conflict With Numerous Federal Circuit Court of Appeals Decisions.

Not only is the Circuit Court's decision contrary to the intent of *Cannelton*, but it is also in direct conflict with decisions of several other federal circuit courts. In *United States* v. *Henderson Clay Products*, 324 F.2d 7 (5th Cir. 1963), the taxpayer, an integrated miner/manufacturer of brick (manufactured from ball clay) had claimed depletion on its mineral income from the clay on the basis of what it claimed to be representative sales of such clay by independent miners at $10.50 per ton. The taxpayer sold its brick for $8.75 per ton. The Fifth Circuit, following *Cannelton*, held that the miner/manufacturer is to be treated as selling the crude mineral to itself insofar as the depletion allowance is concerned, and that while sales of ball clay may have taken place at $10.50 a ton, that price "in no way represents the price which a non-integrated brick manufacturer [the taxpayer's disintegrated manufacturing half] would pay for clay with which to make brick." 324 F.2d at 15. Thus, the price which would be paid in an arm's-length transaction by the manufacturing half of an integrated miner/manufacturer to its mining half was held to be controlling. To the same effect *see Henderson Clay Products* v. *United States*, 377 F.2d 349 (5th Cir. 1967).

Similarly, in *Kaiser Steel Corp.* v. *United States*, 411 F.2d 335 (9th Cir. 1969), the Ninth Circuit Court of Appeals, in attempting to determine a representative market or field price for an integrated miner/manufacturer's iron ore, held that

> [c]onstructive gross mining income is the amount which would have been earned if the mineral manu-

facturer were disintegrated and the raw minerals were sold by its mining division as a separate entity to its manufacturing division, likewise a separate entity. 411 F.2d at 337.

The Court went on to find that while sales into the taxpayer's locale could establish a representative price, these prices must be adjusted to take into account the taxpayer's competitive advantage in operating mines closer to its customers with lesser freight charges than the independent miner selling into its locale. 411 F.2d at 339. This result is an implicit recognition that the representative price for an integrated miner/manufacturer's raw mineral is the price that its manufacturing half would pay for the mineral, if disintegrated. (*See infra* for a full discussion of this case.)

III. The Petition for Certiorari Should Be Granted Because the Circuit Court's Decision With Respect to the Adjustment for Freight Differentials Is in Conflict With the Ninth Circuit Court of Appeals Decision in Kaiser Steel Corp. v. United States.

In *Kaiser Steel Corporation* v. *United States, supra,* the taxpayer was an integrated miner/manufacturer who mined iron ore which it then consumed in its own steel factories. At that time there was only one independent iron ore miner on the West Coast, and he was located in Utah (the taxpayer was located in California). The independent miner sold substantial amounts of iron ore to the taxpayer and others on an f.o.b. mine basis. While holding that these sales into the taxpayer's *market area* would be evidence of a representative price in the area, the Ninth Circuit held that the f.o.b. price of the sales would have to be adjusted for the freight differential from the independent

operator's mine to the taxpayer's mines.[4] The Court stated its rationale on this key issue as follows:

> "In constructing Kaiser's gross mining income, we must assume that both Kaiser and Utah Construction [the independent miner] are independent miners freely competing with one another for the customers in their marketing area. Since those customers are both in California, . . . Kaiser the miner has a competitive advantage in operating mines closer to the customers with lesser freight charges than Utah Construction has to pay.[5]

That the Court's reasoning is sound is a matter of common sense. Also, it is significant that the same line of reasoning is reflected in the instant case in the statement made by Youngstown Sheet and Tube Steel Company. *See* District Court Joint Exhibit No. 1-CC. Youngstown testified that it purchased limestone at a higher f.o.b. mine price ($2.26 per net ton in 1961) from Carbon Limestone Company and Bessemer Cement Company than was otherwise charged by other miners because Carbon and Bessemer were located nearer to it, thus making the delivered price (including transportation charges) less than from the other miners. The expert testimony at trial similarly established that the only relevant price to a purchaser is the delivered price.

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[4] The taxpayer also mined coking coal, but in Utah, and then shipped this coal to its California factories. The Court did not adjust the f.o.b. price of coking coal sales to the taxpayer's California factories from the independent miner since the evidence showed that the freight rates were the same from the taxpayer's coal mines to its factories as from the independent coal miner to the taxpayer's factories.

[5] *See Kaiser, supra*, at 339.

The Third Circuit found *Kaiser* irrelevant in the petitioner's situation for several reasons. First, the Court did not consider the petitioner's marketing area to be limited to Bellefonte. However, as discussed *supra*, this itself is in direct conflict with *Kaiser*, which limited the integrated miner/manufacturer's market to its consumption area.[6]

Secondly, the Third Circuit found that *Kaiser* was not apposite since it dealt with an integrated miner/manufacturer having its mining and manufacturing facilities geographically separated. Unfortunately, the Court seems to have missed the whole point of *Kaiser*. Under the rationale of *Kaiser*, it is irrelevant whether a miner/manufacturer has all of its operations in one place or if the mining and manufacturing halves are separated. The only relevant fact is whether the mining half of the integrated miner/manufacturer is nearer to its manufacturing operations than the independent miner. If so (as was the situation in *Kaiser* and as is the instant case), a freight differential exists and should be taken into account in determining a representative field or market price.[7]

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[6] *See Kaiser, supra*, at 338.

[7] In fact, this Court in *Cannelton, supra*, in determining that there was a market for raw clay, noted that such clay was being sold in an area of Indiana, some distance from the taxpayer's facilities, for $1.60 to $1.90 per ton, and that transportation costs from that area to the taxpayer's operation ran from $4.58 to $5.50 per ton. Thus, the Court implicitly recognized the need to take freight differentials into account, although admittedly "representative price" was not an issue before the Court. *See Cannelton, supra*, at 80. Freight and location differentials, while unimportant in a determination of what is a "marketable product" are highly relevant and indeed critical in any determination of the appropriate field or market and the representative price, if any, to be derived therefrom.

IV. The Petition for Certiorari Should Be Granted Because of the Necessity for the Supreme Court To Answer an Important Unsettled Federal Tax Question—What Is the Proper Method of Determining a Representative Field or Market Price for Purposes of Computing Percentage Depletion Under Sections 611 and 613 of the Internal Revenue Code?

From the above discussion, it quickly becomes apparent that the federal tax law is in a state of confusion with respect to the determination of the percentage depletion to which an integrated miner/manufacturer is entitled under sections 611 and 613 of the Internal Revenue Code. While this Court has provided guidelines in *Cannelton, supra,* for determining when the mining process ends and the manufacturing process starts, it did not specifically deal with how to value the mineral for purposes of determining the integrated miner/manufacturer's constructive income from its mining operations. Some guidance was provided to the extent that it is clear that the value of the mineral is to be determined as if the taxpayer was disintegrated and sold to itself. However, the unanswered question is what sales are to be relied upon in calculating the price at which a disintegrated miner would sell to its manufacturing half. In this respect various courts have reached different conclusions, some basing the price on sales from the taxpayer's locale to other areas,[8] some on sales from outside the taxpayer's locale into that area,[9] and in this case, on sales made outside the taxpayer's locale to other areas outside the locale.

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[8] *See Hugoton Production Co.* v. *United States,* 315 F.2d 868, 877 (Ct. Cl. 1963) and *Phillips Petroleum* v. *Bynum,* 155 F.2d 196, 197-8, 201 (5th Cir. 1946).

[9] *See Kaiser Steel Corp.* v. *United States, supra.*

Additionally, it is also necessary to determine what are representative sales in that "market or field".

This determination of a representative field or market price is critical to a proper calculation of the income of an integrated miner/manufacturer. If not calculated properly, the miner/manufacturer will either pay too much or too little taxes. Since a large majority of the members of the National Lime Association are integrated miner/manufacturers and many are currently using the representative field or market price method to determine gross income from mining (and others may use this method at some time in the future), the Association has a direct interest in this issue. Furthermore, numerous other integrated miner/manufacturers of a variety of minerals use this method for determining their gross income from mining.

A decision by the Court on the proper application of this method would go far toward eliminating current and potential future conflicts between taxpayers and the Internal Revenue Service and would consequently ease the administration of the tax system, as well as making it more uniform and equitable.

CONCLUSION

In view of the conflicting decisions of this Court and Federal Circuit Courts of Appeals with the decision in this case, as well as the important unsettled federal tax question presented by this case, the Court should grant the petition for certiorari.

Respectfully submitted,

JAY W. GLASMANN
1700 Pennsylvania Ave., N.W.
Washington, D. C. 20006
Attorney for Amicus Curiae

APPENDIX

LAW OFFICES
DILWORTH, PAXSON, KALISH, LEVY & COLEMAN
2600 THE FIDELITY BUILDING
PHILADELPHIA, PENNSYLVANIA 19109
(215) KINGSLEY 6-3000

January 9, 1975

Jay Glassman, Esquire
Ivins, Phillips & Barker
1700 Pennsylvania Avenue, N.W.
Washington, D. C. 20006

Re: Warner Company v. United States
Third Circuit Court of Appeals,
Nos. 73-1722 and 73-1723

Dear Mr. Glassman:

You have advised us that the National Lime Association desires to file an amicus brief in support of the Warner Company Petition For Certiorari in the above case. This letter is to confirm that Warner Company consents to the filing of such an amicus curiae brief by you on behalf of the National Lime Association.

Very truly yours,

/s/ JULES I. WHITMAN
Jules I. Whitman

JIW: bf

cc: Robert H. Bork
Solicitor General of the
United States

January 7, 1975

Jay W. Glasmann, Esquire
Ivins, Phillips & Barker
1700 Pennsylvania Avenue, N.W.
Washington, D. C. 20006

Re: *Warner Company* v. *United States of America*

Dear Mr. Glasmann:

In accordance with your request of January 2, 1975, I hereby consent to your filing of an *amicus curiae* brief on behalf of the National Lime Association in support of Warner Company's petition for a writ of certiorari in the above-captioned case.

Sincerely yours,

ROBERT H. BORK
Solicitor General

In the Supreme Court of the United States

OCTOBER TERM, 1974

No. 74-965

WARNER COMPANY, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINIONS BELOW

The opinion and order of the district court (Pet. App. C, A32-A74) are not reported. The opinion of the court of appeals (Pet. App. B, A6-A31) is reported at 504 F. 2d 689.

JURISDICTION

The judgment of the court of appeals was entered on September 27, 1974. A petition for rehearing *en banc* was filed on October 10, 1974, and denied on November 7, 1974. The petition for a writ of certiorari was filed on February 5, 1975. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether, in determining for purposes of the depletion allowance what portion of the income of petitioner, an integrated miner-manufacturer, was from mining, the court of appeals correctly held that a "representative market or field price" existed for petitioner's limestone so that the "proportionate profits" computation method was inapplicable.

STATUTES AND REGULATIONS INVOLVED

The pertinent provisions of Sections 611 and 613, Internal Revenue Code of 1954, and of Section 1.613-4, Treasury Regulations on Income Tax (1954 Code), are set forth at Pet. 3-4, and at Pet. App. A, A1-A5.

STATEMENT

Petitioner is engaged in the mining and the processing of limestone into lime. The kind and quality of limestone mined and used by petitioner in making lime is used also as a fluxing agent in the production of steel. During the taxable years in issue (1956-1959, and 1961), petitioner extracted between 387,794 and 569,914 net tons of limestone which were used in its lime kilns. Petitioner used the stope method of mining to extract the limestone and incurred mining costs in excess of $2.00 per ton. As an accommodation to obtain the good will of its customers, petitioner sold small amounts of limestone at $2.00 per ton (Pet. App. B, A10-A11; Pet. App. C, A35-A36).

During the period 1956-1961, National Gypsum Company and Standard Lime and Cement Company were petitioner's principal competitors in the manufacture of lime. Like petitioner, these companies were integrated miner-manufacturers. They mined the same kind and grade of limestone and incurred approximately the same costs as petitioner. National Gypsum Company sold no limestone. However, Standard Lime and Cement Company sold approximately 10,000 to 15,000 net tons of limestone per year to various steel companies at an f.o.b. quarry price of $1.75 per ton, a price based upon the competitive conditions of the market (Pet. App. B, A11-A12; Pet. App. C, A40-A44).

In addition, Whiterock Quarries and Valley View Lime Company also mined the same quality limestone as petitioner in the same area and sold it on the market, largely to steel companies in Pittsburgh, at f.o.b. quarry prices ranging from $1.55 to $1.74 per ton. Neither sold limestone to

the integrated miner-manufacturers in the area. From 1956 through 1961, Whiterock Quarries and Valley View Lime Company mined and sold 169,519 and 345,589 tons of limestone, respectively, or 7.3 percent of the total net tonnage of limestone produced by the three integrated miner-manufacturers (including petitioner) and 25.7 percent of the limestone produced by petitioner (Pet. App. B, A12; Pet. App. C, A44-A47).

Petitioner's operations were at Bellefonte, Pennsylvania, which is located in the center of a high-calcium limestone producing area stretching through Virginia, West Virginia, and Pennsylvania. At least five producers of limestone of like kind and grade to that of petitioner's sold vast quantities of limestone to steel producing and lime-making companies in Pittsburgh, Johnstown, and Bethelehem, Pennsylvania. This is the same market in which Whiterock Quarries and Valley View Lime Company competed. These sales, f.o.b. mine or quarry, ranged from $1.46 to $1.74 per net ton. No sales were found at or above $2.00 per ton (Pet. App. B, A12-A13; Pet. App. C, A48-A57).

In computing its percentage depletion deduction for the years in issue, petitioner used the so-called "proportionate profits" method. That method derives the gross income from mining by dividing the total gross sales by the proportion that mining costs bear to total costs. However, on audit, the Commissioner of Internal Revenue determined that petitioner was not entitled to use the proportionate profits method because there existed a representative market or field price of about $1.70 per net ton f.o.b. quarry for petitioner's limestone (Pet. App. C, A61).

In this income tax refund suit brought by petitioner in the United States District Court for the Eastern District of Pennsylvania, the district court upheld petitioner's contention that there was no representative market or field price upon which to base a depletion allowance because:

(1) the relevant market area was limited to Bellefonte, Pennsylvania, where petitioner had its mine and plant, and there were only insignificant sales of limestone within that area during the taxable years, and (2) petitioner could not have sold its limestone at a profit. Accordingly, the district court held that petitioner was entitled to use the proportionate profits method (Pet. App. C, A60-A74).

The court of appeals reversed. It concluded that: (1) the criteria applied by the district court in determining a representative market or field price were contrary to *United States* v. *Cannelton Sewer Pipe Co.*, 364 U.S. 76, as well as the decisions of other courts; (2) in the relevant market, which included the greater Pittsburgh area, competitive sales of limestone at a maximum of $1.75 per net ton established a representative market or field price for petitioner's limestone; and (3) it was immaterial that, when the representative price was employed in computing petitioner's constructive mining income, petitioner could not show a profit on which to base a depletion allowance because of its high mining costs of $2.00 per net ton (Pet. App. B, A6-A24).

ARGUMENT

1. Section 611(a) of the Internal Revenue Code of 1954 permits a reasonable allowance for depletion in the case of mines and other natural deposits. Section 613 sets forth the percentage method of depletion. For the years in question, the allowance for limestone was 15 percent of the "gross income from the property" less royalties paid by the taxpayer. However, the depletion allowance cannot exceed 50 percent of the net taxable income from the property. In the case of hard minerals, "gross income from the property" is defined in Section 613(c)(1) as "gross income from mining."

If a miner simply sells his raw mineral, without applying any non-mining process, his gross income from mining is his actual gross sales. However, because a portion of the gross income of an integrated miner-manufacturer, such

as petitioner, includes income from sources other than mining, the depletion base of such an integrated miner-manufacturer is not its gross sales but the amount of income which is computed to be from the mining of the raw mineral. This was settled by *United States* v. *Cannelton Sewer Pipe Co.*, 364 U.S. 76, where this Court held that an integrated miner-manufacturer's gross income from mining should be computed at the point where a non-integrated miner would be ready to ship and sell the raw mineral. In so holding, the Court emphasized that there should be no discrimination between integrated producers and non-integrated miners; that depletion is an allowance "for exhaustion of mineral assets alone" which cannot be extended for the benefit of "manufacturers or the high-cost mine operator" (*id.* at 86, 88).

The computation of an integrated miner-manufacturer's gross income from mining is governed by Treasury Regulations, Section 1.613-4(c) *et seq.*. The preferred measure is set forth in Section 1.613-4(c)(1), which provides that the computation shall be based upon the representative market or field price "of an ore or mineral * * *." However, if a representative market or field price cannot be ascertained, then the proportionate profits method may be employed. See Section 1.613-4(d). Under that method, an integrated miner-manufacturer's constructive gross income from mining is derived from the actual gross sales of the manufactured product by allocating such gross sales between mining and non-mining operations in the proportion which mining costs bear to the total costs of the manufactured product. See *Whitehall Cement Manufacturing Co.* v. *United States*, 369 F.2d 468, 472 (C.A. 3).

In determining a representative market or field price, Section 1.613-4(c) of the Regulations provides that the objective is to "ascertain, on the basis of an analysis of actual competitive sales by the taxpayer or others, the dollar figure or amount which most nearly represents the approximate price at which the taxpayer, in light of market conditions, could have sold his ores or minerals if * * * the tax-

payer had sold [them] * * *." In this case, the court of appeals' opinion amply demonstrates that there was a relevant market—the steel industry in the greater Pittsburgh area—in which the evidence established a representative market or field price of less than $1.74 per net ton f.o.b. mine for petitioner's kind and grade of limestone. Petitioner's mining costs exceeded this representative market or field price so that it had no taxable income from mining. Since Section 613(a) limits the depletion allowance to 50 percent of the net taxable income from the property, petitioner was not entitled to any depletion allowance under Section 613(a).

2. In challenging the decision of the court of appeals that there was a representative market or field price for its limestone, petitioner asserts (Pet. 10-15) a conflict with *United States* v. *Cannelton Sewer Pipe Co., supra.* Invoking the statement in *Cannelton* that "the miner-manufacturer is but selling to himself the crude mineral that he mines, insofar as the depletion allowance is concerned" (364 U.S. at 87), petitioner argues (Pet. 14) that the presumption must be that its mine was operating at a profit since it was operating at an overall profit each year. More particularly, petitioner contends (Pet. 13) that the area within which freight costs do not become an altering factor must be taken into account because integrated miner-manufacturers have a "fortuitous advantage in having a geographically close consumption market * * *."

The decision below is entirely consistent with *Cannelton.* There, this Court considered sales of raw fire clay and shale mined by an integrated miner-manufacturer as much as 140 miles from the taxpayer's mine and manufacturing plant as within the relevant market area even though the record showed: (1) that because of high freight costs it would not have been economically feasible for the taxpayer to have purchased clay that far from its manufacturing plant (364 U.S. at 80, 86); and (2) that the taxpayer's mining costs were higher than the amount

it could have received for the raw clay on the open market (364 U.S. at 86-88). Thus, in determining a representative market price, the Court did not consider itself bound to a narrow geographic area simply because the taxpayer would not have incurred high freight costs or because its mining operation would not yield a profit.

Similarly, in this case, the record shows that the relevant market, in which petitioner could have sold its limestone and in which its potential competitors sold their limestone, was the greater Pittsburgh area. Thus, the court of appeals properly derived a representative price from significant sales in that area. The fact that petitioner's mining costs were so high that it could not sell its limestone at the representative price without incurring a loss did not make the representative price any less applicable to petitioner than it would be to a miner-manufacturer who could realize a gain by selling comparable limestone in the same market.

Moreover, in limiting the market to the location of the integrated miner-manufacturer's manufacturing plant, petitioner seeks to place the integrated miner-manufacturer in a better position than his non-integrated counterpart by making the integrated miner-manufacturer's gross income from mining turn on the profitability of the finished product. This difference in treatment is precisely contrary to *Cannelton*.

3. Petitioner further argues (Pet. 15-19) that the decision below conflicts with *United States* v. *Henderson Clay Products*, 324 F.2d 7 (C.A. 5). That case, however, is factually distinguishable. There, the taxpayer, a Texas integrated miner-manufacturer of clay into bricks, sold its finished product for less than the price of raw clay in Kentucky and Tennessee, and unsuccessfully attempted to compute its percentage depletion allowance on the amount that raw clay sold for in Kentucky and Tennessee. The Fifth Circuit determined that the price for clay in Kentucky and Tennessee could hardly be representative,

since otherwise taxpayer would have sold his clay in that market and not have incurred the expense of manufacturing bricks.

In this case, the record not only shows that there were sales of Bellefonte limestone in Pittsburgh but also that there were many sales in Pittsburgh of the same quality of limestone as petitioner's from other locations of equal or greater distance from Pittsburgh than Bellefonte. The representative price for the entire area was therefore fully applicable to a miner which operated in the area, such as petitioner. There were no comparable sales of Texas clay in Kentucky and Tennessee or vice versa in *Henderson Clay Products*.

4. Finally, petitioner contends (Pet. 19-21) that the decision below conflicts with *Kaiser Steel Corp.* v. *United States*, 411 F.2d 335 (C.A. 9). There, the taxpayer, an integrated miner-manufacturer and major consumer of iron ore in California, purchased iron ore from a non-integrated miner in Utah, which was the only non-integrated miner in the area. The price paid for the Utah ore was held to be the representative market price. Since that price was an f.o.b. mine price, and since there were no sales from the locality in California where the taxpayer mined its ore, the court adjusted the price upward because of lower freight costs from the California mine to the consumption area. The fact that the Kaiser manufacturing plant was located in the principal consumption area was purely coincidental.

Whatever the merits of the *Kaiser* decision, it is inapplicable here because the representative market price for Bellefonte limestone was the price paid in Pittsburgh. This is the market in which petitioner could have sold its limestone, if it had so desired. Since there was little disparity in freight rates from Bellefonte and other producing areas of equal distance to Pittsburgh (Pet. App. B, A24, n. 17) and since there was an f.o.b. Bellefonte mine price in the Pittsburgh market, there could be no upward adjustment

to the f.o.b. mine price for petitioner's limestone under the *Kaiser* rationale. Moreover, there is no evidence in the record that anyone would have paid more for Bellefonte limestone in Bellefonte than the f.o.b. mine price set in the market where petitioner could have sold its limestone.[1]

CONCLUSION

For the reasons stated, it is respectfully submitted that the petition for a writ of certiorari should be denied.

ROBERT H. BORK,
Solicitor General.

SCOTT P. CRAMPTON,
Assistant Attorney General.

GRANT W. WIPRUD,
DAVID ENGLISH CARMACK,
Attorneys.

MARCH 1975.

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[1]The court of appeals correctly held inapplicable Section 1.613-4 (e)(2) of the Treasury Regulations (Pet. App. B, A24, n. 17), which was applied in *Kaiser* and upon which petitioner relies (Pet. 20, n. 13), because there was already an established f.o.b. mine price for Bellefonte limestone.

CERTIORARI DENIED